TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 515

THE UNITED STATES OF AMERICA AND FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE, PETITIONERS,

vs.

HENRY H. KAUFMAN, TRUSTEE IN BANKRUPTCY OF ABRAHAM FINKELSTEIN, ISRAEL FINKELSTEIN, ET AL., ETC.

No. 516

THE UNITED STATES OF AMERICA AND FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE, PETITIONERS,

vs.

ALFRED C. COXE, JR., RECEIVER OF JONES AND BAKER, ALLEGED BANKRUPTS

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED JULY 5, 1934.

CERTIORARI GRANTED OCTOBER 15, 1934.

(30,480, 30,481)

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Case 515

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., DECEMBER 9, 1924

Case 516

[fol. 1] IN THE

DISTRICT COURT OF THE UNITED STATES FOR THE SECOND DISTRICT OF NEW YORK

In Bankruptcy. No. —

In the Matter of FINKELSTEIN BROS., 87 Nassau Street, New York City, Bankrupt

PROOF OF CLAIM

Statement of Claims for Taxes Due the United States

Comes, Frank K. Bowers, Collector of Internal Revenue for the 2nd Collection District of New York, a duly authorized agent for the United States in this behalf, and says that Abraham Finkelstein, Bankrupt, is justly and truly indebted to the United States of America for Internal Revenue Taxes as follows:

Nature of tax and statute involved (give section or sections): Income Tax.
Year or taxable period ended: Balance 1919.
Amount of tax: $11,533.30, together with interest at —% per mo. until paid.
Interest began Jan. 22, 1922.
#329,089, 1920 list.

[fol. 2] That no part of said taxes or interest has been paid but that the same are now due and payable at the office of said Collector of Internal Revenue at Custom House, New York City.

That no security therefor is held by the United States and that there be no set-offs or counter-claims.

That this claim is entitled to be paid before all other claims, the priority of the United States for the payment of taxes being fully determined by Section 3466 of the Revised Statutes and Section 64 (a) of the Bankruptcy Act.

And attention is hereby called to Section 3467 of the Revised Statutes which provides that every executor, administrator, or assignee, or other person who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

Dated this 14th day of March, 1923.

(Sgd.) Frank K. Bowers, Collector of Internal Revenue for the 2nd Collection District of New York.

Sworn to and subscribed before me this 14th day of March, 1923. Arthur I. Perry, Notary Public.

[fol. 3] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER TO SHOW CAUSE

Upon reading and filing the annexed petition of Henry H. Kaufman, Trustee in Bankruptcy in this proceeding, verified the 23rd day of February, 1923,

Let William Hayward, United States Attorney for the Southern District of New York, and Frank Bowers, Collector of Internal Revenue for the Second District of New York, show cause before the undersigned at his office No. 299 Broadway, Borough of Manhattan, City of New York, on the 14th day of March, 1923, at 12:30 o'clock in the afternoon of that day, or as soon thereafter as counsel can be heard why an order should not be granted decreeing that the claim of the Government, if any, filed with the undersigned is a claim against the individual estate of Abraham Finkelstein and as such is not entitled to payment out of the funds in the possession of Henry H. Kaufman as Trustee in Bankruptcy of Finkelstein [fol. 4] Bros., and of which bankrupt copartnership Abraham Finkelstein was a member, and further decreeing that there are no funds applicable to the claim, if any, of the United States Government as filed against the individual estate of Abraham Finkelstein, and for such other and further relief as may be just, proper and equitable in the premises.

Dated, New York, February 26th, 1923.

J. J. Townsend, Referee in Bankruptcy.

IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION OF TRUSTEE

To the Hon. John J. Townsend, referee in bankruptcy:

The petition of Henry H. Kaufman, respectfully shows and alleges [fol. 5] to this Court that he is the Trustee in Bankruptcy in this proceeding, and has duly qualified as such.

That your petitioner as Trustee has filed his final report and hearing has been duly held thereon, and said accounts are about to be passed by the Referee.

That under date of February 7th, 1923, your petitioner received a letter from the United States Attorney's Office for the Southern District of New York advising that there is due to the United States Government on account of income tax for the year 1919 the sum of $11,523.30 with interest thereon at the rate of 1% per month from January 22nd, 1922, from Abraham Finkelstein, one of the above named bankrupts, and the said letter also advises your petitioner that a proof of claim was filed against the individual estate of Abraham Finkelstein with the Referee in Bankruptcy on November 25th, 1922.

Your petitioner as Trustee in Bankruptcy in this proceeding did not receive any individual assets of Abraham Finkelstein. The assets which came into the possession of your petitioner were the assets of the copartnership of Finkelstein Bros. of which Abraham Finkelstein was one of the three members.

That before a final order of distribution is entered in this proceeding, your petitioner desires to have a decree of the Court disallowing the claim of the Government for the tax as aforesaid against the estate of Finkelstein Bros. where as a matter of fact the claim is against Abraham Finkelstein, an individual, who was one of the three members of the bankrupts herein.

Wherefore, your petitioner respectfully prays for the granting of [fol. 6] the annexed order to show cause directed against the Collector of Internal Revenue for the Second District of New York and against William Haywood, United States Attorney for the Southern District of New York, to show cause why said claim as filed should not be disallowed as a claim against the bankrupt estate of Finkelstein Bros., a copartnership herein in bankruptcy, had for such other and further relief as may be just, proper and equitable in the premises.

Henry H. Kaufman, Petitioner.

Jurat showing the foregoing was duly sworn to by Henry H. Kaufman omitted in printing.

[fol. 7] IN UNITED STATES DISTRICT COURT

Before Hon. John J. Townsend, Referee

#28384

In re FINKELSTEIN BROS.

HEARING BEFORE REFEREE ON PETITION AND ORDER TO SHOW CAUSE

Hearing on Order to Show Cause vs. U. S. Government—Claim

New York, March 14th, 1923, at 12:30 p. m.

Present: Robert P. Levis, 42 Broadway, by Max Sanders, for the Trustee; Victor House for the U. S. Government; Shaine & Weinrib, by Mr. Shaine for the bankrupt; Nathan Frank, for creditors.

The Trustee files the order to show cause.

The Referee: I announce that I do not find any claim on file by the Federal Government.

Mr. Sanders: I move that the Government be foreclosed from filing any claim against Finkelstein Bros.

The Referee: In view of the fact that there has been no distribution of this estate, I shall allow the Government to file any claim it has against this estate, and I will dispose of that claim when filed, according to the law and the fact.

Mr. Sanders: I ask your Honor to direct the Government to file its claim, and I reserve our right to make such motions to bar it at [fol. 8] the time the claim is taken up by your Honor for consideration.

The Referee: I will direct the Government to file this claim, with particulars, and I reserve your rights to object to the claim when filed.

Mr. House: May the matter then go over until such time as I can get all my facts together? And may I also now have noted upon the record that I am informed by the Collector of Internal Revenue for the Second District of New York that he has filed the claim in this matter against Abraham Finkelstein, one of the partners, which asserted, however, against the partnership estate as well as the Abraham Finkelstein individual estate $11,523.30, for income taxes for the year 1919, remaining unpaid, with interest thereon at the statutory rate. I understand that claim was filed November 25th, 1922, and believe that it has been mislaid or lost. I shall see that a copy of that is filed.

Mr. Sanders: I also ask your Honor to give us the right, or reserve our right, to oppose the attempt of the Government to file a claim with your Honor against Finkelstein Bros., if the claim is against Abraham Finkelstein. I want at that time to be given an opportunity to argue that motion, that your Honor refuse to accept that claim for filing.

The Referee: I think I shall let any claim be filed without prejudice to the rights of the Trustee to have it disallowed as against the partnership assets.

Adjourned to March 28th, 1923 at 3:30 p. m.

[fol. 9] Before Hon. John J. Townsend, Referee

#28384

In re FINKELSTEIN BROS.

Order to Show Cause—Trustee vs. United States Government

New York, March 28, 1923, at 3.30 p. m.

Present: Robert P. Levis, Esq., Attorney for Trustee, by Max E. Sanders, Esq.; Victor House, Esq., Assistant United States Attorney;

William M. A. O'Neill, Esq., Special Assistant United States Attorney.

The Referee has before him the following:

Proof of claim filed by the Collector of Internal Revenue with the Referee on March 15th, 1923, in the sum of $11,523.30 exclusive of interest, against Finkelstein Brothers of 87 Nassau Street.

Also claim filed the same date in the sum of $11,523.30 exclusive of interest, against Abraham Finkelstein.

Mr. Sanders: I have noticed from the claim that has been filed with the Referee on the 13th of March, 1923, that the address of the Finkelstein Brothers referred to in the claim is located at 87 Nassau Street.

The records of the Referee show that the Finkelstein Brothers who [fol. 10] are in bankruptcy in this proceeding had their place of business at 3 West 19th Street, Borough of Manhattan, New York City, during the years 1919-1920.

I therefore ask that the matter be adjourned so as to give Mr. House and myself an opportunity to find out whether the claim is properly against the taxee in this proceeding, and that adjournment to be without prejudice to any rights I may have to move to strike this claim from the records.

The Referee adjourned the hearing to Tuesday, April 3rd, 1923, at 3:30 P. M.

Before Hon. John J. Townsend, Referee

#28384

In re FINKELSTEIN BROTHERS

Hearing on Order to Show Cause—Trustee vs. United States Government

New York, April 3rd, 1923, at 3.30 p. m.

Appearances: Mr. Crawford, representing United States Attorney.

By consent hearing adjourned to Wednesday, April 10th, 1923, at 3 P. M.

[fol. 11] Before Hon. John J. Townsend, Referee

#28384

In re FINKELSTEIN BROS.

Adjourned Hearing on Claim of United States Government

New York, April 10th, 1923, at 3 p. m.

Present: Max E. Sanders, Attorney for Trustee, by Max Sisenwein, Esq.; Mr. O'Neill, Special Assistant United States Attorney.

By consent hearing adjourned to Wednesday, April 18th, 1923, at 3 P. M.

Before Hon. John J. Townsend, Referee

#28384

In re FINKELSTEIN BROTHERS

Adjourned Hearing on Order to Show Cause—Trustee vs. United States Government

New York, April 18th, 1923, at 3 p. m.

Present: Robert P. Levis, Esq., Attorney for Trustee, by Max E. [fol. 12] Sanders, Esq.; William M. A. O'Neill, Esq., Special Assistant United States Attorney; I. Michaelsohn, Esq., a creditor.

Mr. O'Neill addressed the Referee.

Mr. Sanders addressed the Referee.

The Referee: As I understand it, the Government are claiming, and they are moving to be paid out of the partnership ahead of the unsecured creditors.

Mr. Sanders: That is the point.

Mr. O'Neill: And upon that question we ask leave to submit a memorandum at the date you specify or upon the adjourned date, setting out what our contention is, that our contention is correct, that the Government has the right to be paid out of the assets of the co-partnership.

The Referee: Ahead of the unsecured creditors?

Mr. O'Neill: Yes, sir. If it is agreeable to you we will make an adjourned date, and I will submit a memorandum.

The Referee: You ascertain the tax under the Statute against John Jones. If John Jones has nothing in the funds, you have either got to take one case or another; you have either got to say that the partnership is liable for John Jones ahead of the creditors.

Or else you have got to say that there are facts in connection with the partnership estate which show that it gives you the right to call upon it to pay John Jones' taxes on this date.

[fol. 13] Unless you take either horn of the dilemma and say any tax against John Jones comes ahead of the creditors of the partnership estate——

Mr. O'Neill: That is what we do assert.

Mr. Sanders: That is all we have got to do; set up proof that Mr. Kaufman did not receive any moneys belonging to his individual estate, and as far as we are concerned, rest our case.

Adjourned to Thursday, April 26th, 1923, at 4 p. m.

Before Hon. John J. Townsend, Referee

#28384

In re ABRAHAM FINKELSTEIN, ISREAL FINKELSTEIN, and NETTIE FINKELSTEIN, Individually and as Co-partners, Trading as Finkelstein Brothers

Adjourned Hearing on Order to Show Cause—Trustee vs. United States Government (Claim for Income Tax)

New York, April 26th, 1923, at 4 p. m.

Present: Henry H. Kaufman, Esq., Trustee, in person, Robert P. Levis, Esq., attorney for Trustee, by Max E. Sanders, Esq.; William [fol. 14] H. Hayward, Esq., United States Attorney for the Southern District of New York, and for the Collector of Internal Revenue of the Second District of New York, represented by William M. A. O'Neill, Esq., Assistant United States Attorney, of Counsel; Nathan Frank, Esq., Attorney for I. Michaelson & Son, a creditor.

Mr. O'Neill: The Government's contention is that the Government's claims against the individual members of this partnership are payable out of the partnership estate prior to the payment of the general co-partnership creditors, and the priority confirmed by Section 3466 of the Revised Statutes attaches to the partnership funds as well as to the individual assets of the co-partnership.

Mr. Sanders: As I understand it, Mr. O'Neill, your claim here is that Arbaham Finkelstein owes you how much?

Mr. O'Neill: The amount of the claim of $11,523.30.

Mr. Sanders: As I understand it, Mr. O'Neill, your contention is that there is due the Government approximately $11,000 from the estate of Abraham Finkelstein?

Mr. O'Neill: It is stated that the Government has filed claim in the sum of $11,523.30 against one Abraham Finkelstein, member of the co-partnership of Abraham Finkelstein, Isreal Finkelstein, and Nettie Finkelstein, individually, and as co-partners, trading as Finkelstein Brothers.

[fol. 15] HENRY H. KAUFMAN, being first duly sworn by Richard O. Smith, Notary Public in the office of the Referee, testified as follows:

Examined by Mr. Sanders:

Q. What is your address, please, Mr. Kaufman?
A. My business address is 115 Broadway.
Q. Were you appointed Receiver in Bankruptcy in this proceeding?
A. I was.
Q. Do you remember when that was?
A. November 20th, 1920.
Q. Did you qualify as Receiver?
A. I did.

Q. Did you file your accounts in this Court as Receiver?

A. I have.

Q. As Receiver in this proceeding did you receive any funds for the individual estate of Abraham Finkelstein?

A. None.

Q. All the assets that came into your possession, were they assets of the co-partnership, or of the individuals composing that firm?

A. The assets which came into my possession were assets which I was told were assets of the firm, and they represented merchandise, laces and embroideries which I found in the place of business of Finkelstein Brothers, and also moneys collected on outstanding accounts appearing on the books of Finkelstein Brothers which I found in their place of business. I received no assets from any source whatsoever which belonged to Abraham Finkelstein individually.

Q. Were your accounts as Receiver passed upon by the Court?

A. They were.

Q. Were you subsequently discharged as Receiver?

A. I was.

Q. Did you turn over your funds as Receiver to yourself as Trus [fol. 16] tee?

A. I did, with the exception of one fund, which I was directed to keep in a special account.

Q. That was subject to reclamation?

A. Yes, sir. I have since disbursed, pursuant to the order of the Court, that money, but that money was also moneys that was realized from the sale of assets of the firm of Finkelstein Brothers.

Q. Now, since then you were elected Trustee, at the first meeting of creditors?

A. I was.

Q. You qualified as Trustee?

A. I did.

Q. And the moneys that you had collected as Receiver were turned over to yourself as Trustee?

A. Correct.

Q. Did you during your Trusteeship collect any funds belonging to the individual estate of Abraham Finkelstein?

A. I did not.

Q. And the moneys you now have on hand are the proceeds of sale of the assets at public auction during the Receivership, and the collection of outstanding accounts that were turned over to yourself as Trustee by yourself as Receiver?

A. Correct.

Q. Was the final account as Trustee filed in this Court?

A. Yes, sir.

Q. And your Receiver's accounts were filed in this Court?

A. Yes, sir.

Mr. Sanders: I offer the Trustee's account and the Receiver's account in evidence.

Examined by Mr. O'Neill:

Q. Mr. Kaufman, when you took charge did you go over these accounts yourself?

[fol. 17] A. No, personally I did not go through the books myself. My representative, Mr. Frederick H. Nicholls went through the books, in conjunction with Miss Nettie Finkelstein and made up a list for me of the outstanding accounts due Finkelstein Brothers as shown by their books; and after such list was prepared I went over them, personally, with them.

Q. You stated that you employed Mr. Nicholls, Mr. Frederick H. Nicholls, an accountant?

A. No; he was my representative at the place of business. He was not an accountant, but he understood books.

Q. He is not an accountant?

A. No.

Q. Is it customary for the Trustee to accept the report of one who is not an accountant?

A. Certainly.

Q. It is the custom?

A. The point I make in answer to your question is, I can do it myself, go through the books and ascertain what the receivables are, if I wanted to take up the time; but in order to avoid the necessity of doing that, I had Mr. Nicholls do it. He is fully competent to do it, because he has done it in hundred of cases and understands books thoroughly. He is not an accountant, nor is he generally employed as a bookkeeper.

Q. Am I to understand that you accepted the report of the condition of the books of Mr. Fred Nicholls, who you state is not an accountant?

A. No.

Q. Did anyone assist Mr. Nicholls in the examination of the books?

A. He availed himself of the services of Miss Netti Finkelstein, who was formerly the bookkeeper of Finkelstein Brothers and was familiar with all their affairs.

Q. Is this Miss Netti Finkelstein a member of that co-partnership?

A. Yes, sir.

[fol. 18] Q. Did you examine the condition of Abraham Finkelstein at this time?

A. I did.

Q. What did he inform you as to his financial condition at this time?

A. He stated to me that all the property that he had in the world had been placed by him in the firm of Finkelstein Brothers; that he had no individual assets.

Q. Did you examine him in any proceeding to ascertain whether his statement was true, that he had no assets at that time?

A. I did not, but my attorneys did.

Q. And do you know the result that they found?

A. I understand that they found no individual assets belonging to Mr. Abraham Finkelstein.

Q. Are you prepared to swear that you are satisfied that Abraham Finkelstein has no assets?

A. At the present time? That I cannot tell.

Mr. Sanders: I object to the form of the question.

Q. Are you prepared to swear that Abraham Finkelstein had no assets at the time you examined him?

A. I am prepared to swear that from the investigations that I made, that it appeared that Mr. Finkelstein was telling me the truth when he said he had no assets other than his interest in the firm of Finkelstein Brothers.

Q. Did anybody else inform you that Abraham Finkelstein at this time had no assets, so far as it was found?

A. My attorneys reported to me that from the investigation that they had made, and the examinations, that they found no individual assets of Abraham Finkelstein, and as I recall it, in the [fol. 19] schedules that he filed, which were sworn to by him, he did not schedule any individual assets.

Q. Mr. Kaufman, are you acquainted with the division of the profits as it existed in this firm?

A. I may have known it at the time, but I do not recall it at this late date.

Q. Do you know of your own belief whether or not Abraham Finkelstein had any assets due and owing him in the partnership?

A. The only thing I can say in answer to this question is to say that he had nothing due him until the creditors had been paid in full.

Q. Do you know what his interest was in this partnership?

A. You mean his percentage?

Q. His percentage.

A. I don't recall what it was. He had a very substantial interest.

Q. Up and above the amount due to the creditors, do you recall at this time if there are any assets in favor of Abraham Finkelstein?

A. No, there were not.

Q. Then I am to understand that at no time did you employ any certified accountant upon these books?

A. I did employ a certified accountant on these books at a date subsequent to the time that I had Mr. Nicholls make up for me a tentative statement of the outstandings, and I then employed, as I recall it, Samuel D. Leidesdorf & Company.

Mr. O'Neill: I renew the Government's contention that the Government's claim is against the individual Abraham Finkelstein, member of the co-partnership of Abraham Finkelstein, Israel Finkelstein, and Netti Finkelstein, individually, and as co-partners, trad- [fol. 20] ing as Finkelstein Brothers, and that the claim is payable out of the partnership estate prior to the payment of all gen-

eral co-partnership creditors, and the priority confirmed by Section 3466 of the Revised Statute attaches to the partnership fund as well as to the individual assets of the co-partnership.

Q. How much money is there in the estate of this bankrupt firm?

A. There is some cash, but the exact amount I don't recall; but it appears in my final account as Trustee. Of course, since my accounting has been filed there is a certain amount for interest on the moneys deposited on which I will file a supplementary report The amount of interest is very small.

Q. Can you recall the approximate amount, the exact or approximate amount?

A. I don't remember, but it my recollection serves me, it is about $14,000.

Q. Have you at any time paid a divident in this estate?

A. There has been a divident of 15% already paid to creditors prior to the filing of the Government's claim, or prior to the time that I had knowledge that the Government intended to serve a claim.

Mr. Sanders: I offer in evidence the schedules filed by Abraham Finkelstein with the Clerk of the United States District Court for the Southern District of New York, and referred to the Hon. John J. Townsend as Referee.

At this time I renew my motion to dismiss the claim filed by the Government on the following grounds:

[fol. 21] First. That the said claim was filed after the year within which claims could be filed had expired and

Second. On the ground that there is no estate, no individual estate of Abraham Finkelstein, and therefore the claim of the Government cannot lie, and

On the further ground that the claim of the Government, if any claim at all, would be against the individual estate of Abraham Finkelstein or any assets received by the Receiver or Trustee in this proceeding from the individual estate of Abraham Finkelstein, and that from the testimony of the Receiver and Trustee of this estate, it would appear conclusively that no assets of the individual estate of Abraham Finkelstein came into his possession; but on the other hand, that the assets that came into his possession were assets of the co-partnership of Finkelstein Brothers.

Mr. O'Neill: I object to that motion, because if there were any strength to be given the same, it would be waived by the appearance here of the bankrupt herein, and further that the Government may file its claim at any time before final distribution of the estate.

Mr. Sanders: I would like to have it noted on the record that Mr. Abraham Finkelstein appears here voluntarily, and that if the Government desires to use him as a witness on any point which they

raised before the Referee, he is ready and willing to testify, and I have no objection.

[fol. 22] The Government will file briefs within ten days and Mr. Sanders will file a reply in brief within seven days thereafter.

—— ——.

Subscribed and sworn to before me this — day of ——, 1923.
—— ——, Referee.

Closed.

IN UNITED STATES DISTRICT COURT

[Title omitted]

STIPULATION

It is hereby stipulated between the attorneys for Frank K. Bowers, [fol. 23] Collector of Internal Revenue for the Second District of New York, the claimant above-named, and for the trustee of the above-named bankrupts, that the total income of the bankrupt Abraham Finkelstein, upon which the tax claimed herein was based, was derived from the business of the co-partnership Finkelstein Brothers; and it is

Further stipulated that the foregoing stipulation may be taken as and in lieu of testimony herein and shall be regarded as part of the record; and it is

Further stipulated that the report of Referee John J. Townsend herein dated June 11, 1923, be deemed the Referee's certificate herein on petition to review his order herein relating to said claim and the payment thereof out of the assets of the partnership Finkelstein Brothers in advance of the payment of general partnership creditors.

Dated, New York, August 20th, 1923.

Robert P. Levis, Attorney for Trustee. Wm. Hayward, United States Attorney for the Southern District of New York, Attorney for Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York.

[fol. 24] IN UNITED STATES DISTRICT COURT

[Title omitted]

OPINION AND REPORT OF REFEREE

To the Honorable Judges of the District Court of the United States for the Southern District of New York:

I, John J. Townsend, Referee in Bankruptcy, have before me a motion arising under an order to show cause, dated February 26,

1923, made by the Referee on the Petition of the Trustee in Bankruptcy, requiring the Collector of Internal Revenue to show cause why an order should not be made decreeing that the above claim is a claim against the individual estate of Abraham Finkelstein and is not to be paid out of the partnership assets in which the individual estate of Abraham Finkelstein has no interest or equity within subdv. f of Section 5 of the Bankruptcy Act.

[fol. 25] Such petition and order to show cause was filed with the Referee March 14, 1923, and accompanies this report.

Accompanying this report are also the stenographer's minutes of the proceedings before the Referee consisting of 20 pages.

The Collector's claim has been filed in duplicate and accompanies this report.

The proof of claim should be read as a whole.

In terms it asserts a claim against Abraham Finkelstein for an unpaid balance of Income Tax for the year 1919, the balance being stated at $11,523.30. Priority in payment before all claims, together with interest at 1% per month until paid beginning January 22, 1922, is also asserted.

The question of priority and of rate of interest will be reserved by the Referee for the present.

The entire Income Tax for the year 1919 asserted against Abraham Finkelstein is $15,364.40 of which he appears to have paid the instalment or one-fourth normally falling due in March, 1920, at $3,841.10. The remaining three instalments or three-fourths aggregating $11,523.30 form the basis of the present claim.

On October 14, 1920, a petition in bankruptcy was filed against the partnership and the partners upon which petition the three partners individually and as a partnership was adjudicated on April 1, 1921.

It does not appear that the Collector prior to the filing of the petition in bankruptcy in October, 1920, ever took any steps against Abraham Finkelstein to collect the unpaid instalments of June 18, 1920, and September 15, 1920, either against the individual property of Abraham Finkelstein, including his interest in the partnership at that time.

[fol. 26] At the hearing it appeared (S. M., pages 13, 18) that all the assets in the hands of the Trustee in Bankruptcy are partnership assets and that the Trustee has no assets otherwise the property of Abraham Finkelstein. It was conceded (S. M., page 17) Abraham Finkelstein had a substantial interest in any surplus of partnership assets remaining after paying partnership debts. It is however conceded that in this there is no surplus.

At the hearing (S. M., page 12) the Government contended that the Collector's claim was payable out of the partnership assets prior to the payment of the general copartnership creditors.

At the hearing (S. M., page 19) the Trustee contended that the Government's claim was only payable out of any individual assets (of which in this case there were none) belonging to the individual estate of Abraham Finkelstein within subdv. f of Section 5 of the Bankruptcy Act.

In other words, the Government's contention is that the tax assessed against Abraham Finkelstein should be paid out of the partnership assets prior to partnership creditors the same as if the Income Tax had been assessed upon the partnership as an entity as was the case under the Revenue Act of 1917; see Title II, Section 201 of that statute which reads as follows:

"That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereafter in this title referred to as the tax) equal to the following percentages of the net income. * * *"

[fol. 27] It is to be noted that Title I of the Act of 1917 imposes an Income Tax upon the income of every individual and that Title II of the Act imposes a graduated excess profits tax on a partnership as an entity.

The Revenue Act of 1918 under which the present tax was imposed upon Abraham Finkelstein was a departure from the plan of the Revenue Act of 1917 in not imposing a tax upon a partnership as an entity but declaredly imposed the tax upon the partner in his individual capacity and in respect to the income, whether distributed or not, which he was entitled to receive from the partnership.

The language of the statute is as follows:

"Sec. 218 (a) That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed."

"Sec. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the [fol. 28] names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners."

It is also to be noted that these sections are found in Part II of the Revenue Act of 1918 entitled "Part II—individuals."

In my opinion the Sovereign in the Act quoted has publicly declared its claim against the taxpayer and that the language of the statute, viz.: Section 218 (a) impliedly, if not expressly, follows or adopts the rule of marshalling laid down in subdv. f of Section 5 of the Bankruptcy Act.

Had the partnership remained solvent and had the Collector pursued Abraham Finkelstein for the unpaid Income Tax the maximum right of the Government, in my opinion, under the Statute would have been to pursue the individual assets of Abraham Finkelstein and to have pursued the latter's interest in the partnership after its affairs were marshalled under the familiar rule.

I find nothing in the Sections 3186 and 3466 or 3467 of the revised statutes of the United States which increases the *res* which the Collector may seize. Those three sections read as follows:

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment-list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon [fol. 29] all property and rights to property belonging to such person; * * *.

"Sec. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied, and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

"Sec. 3467. Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid."

Neither of these three sections attempts to define the assets of the taxpayer which are subject to seizure.

In my opinion the insolvency of the partnership or the partner who is the taxpayer does not increase the rights of the Government.

In other words I do not believe, because the partnership and the individual partners have become insolvent, that for that reason the Government to satisfy an unpaid tax imposed upon one partner as [fol. 30] an individual can seize all the assets of the partnership in advance of the creditors of the partnership.

Non constat but that had the Government acted promptly in 1920 it might have secured from Abraham Finkelstein payment of at least two of the instalments of the tax out of his individual assets including his equity in the partnership.

The fact that the Government delayed collection until after such equity had disappeared and any other assets of Abraham Finkelstein had also disappeared affords no reason why the partnership assets,

which otherwise would have belonged to the partnership creditors, should be now seized by the Government to pay its claim against Abraham Finkelstein as an individual under Section 218 (a) of the Revenue Act of 1918.

I repeat that the present controversy cannot be decided correctly without constantly keeping in mind the text of Sections 218 and 224 of the Revenue Act of 1918 quoted above (S. M., page 4).

Congress having deliberately chosen the plan of taxation indicated in those sections, instead of assessing the income of the partnership as an entity and making the tax thereby payable out of partnership assets in the first instance in case of a failure, the Collector is precluded from asserting the different rule here contended for by him, even if (as he points out) the statutory plan works (as here) to leave the partnership assets to the partnership creditors free from seizure to satisfy a tax imposed on one partner "in his individual capacity."

I read the following cases as supporting the views expressed in this memorandum:

U. S. vs. Hack, 8 Peters, 271;
U. S. vs. Evans, Crabbe, 60; 2 Fed. Cases, #15062.

[fol. 31] The Collector relies on the following cases:

In re Straussberger, 4 Woods, 557; 23 Fed. Cases, #13526.
Lewis vs. U. S., 92 U. S., 618.

In the Straussberger cases the United States had recovered a judgment on a whiskey bond against both of the Straussbergers who were partners in a whiskey business but who had each executed the bond in connection with that business in their individual capacities. It is evident to me that this feature was decisive of the case. The language at page 559, postponing the claims of partnership creditors as well as of separate creditors to the claim of the United States, must be read in connection with the limitation in the language of the opinion on page 558, beginning "When the United States have a claim against one member of a firm and not against the other its priority extends only to the interest of that member, etc., etc."

I cannot read the Lewis case as impairing the prior decision of the U. S. Supreme Court in U. S. vs. Hack. The facts were as follows:

The United States had a claim against the partnership of Jay Cook McCulloch & Co. of London hereafter called the English firm.

The English firm was composed of seven American partners and three English partners.

Jay Cook & Co. of Philadelphia hereafter called the American firm was composed of the seven American partners of the English firm.

On November 26, 1873, the American firm became bankrupt and Lewis was the Trustee in Bankruptcy.

The United States asserted against the Trustee in bankruptcy a [fol. 32] claim against separate estates of the seven American partners in the American firm, they being partners in the English firm which was primarily the debtor to the United States (S. M., page 620).

The Supreme Court merely decided that the United States holding

a claim primarily against the English partnership was not bound to go into a foreign jurisdiction to assert that claim against that partnership before proceeding against the separate estates of the partners in this country but could assert a claim against the separate estates of the partners so far as found in this country in the possession of Lewis the Trustee in bankruptcy of the American firm. The decision cannot in my opinion be read as authority for the converse proposition contended for by the Collector—that the United States in holding a claim against a partner as an individual may assert that claim against the partnership assets ahead of the claims of partnership creditors—which is the proposition condemned in U. S. vs. Hack, supra.

I report that the Trustee in bankruptcy in this proceeding is entitled to a decree barring the claim of the Collector of Internal Revenue against the partnership assets of Finkelstein Brothers in priority to the claims of the creditors of Finkelstein Brothers.

Such order should contain a provision expressly reserving the rights of the Collector of Internal Revenue against the individual estate of Abraham Finkelstein until it is made to appear that such an estate exists in the hands of the Trustee in Bankruptcy.

Dated, New York, June 11, 1923.

J. J. Townsend, Referee in Bankruptcy.

[fol. 33] In United States District Court

[Title omitted]

Motion to Confirm Report

Sirs: Please take notice that a motion will be made at a Stated Term of this Court to be held in the Post Office Building, Borough of Manhattan, City of New York, on the 20th day of June, 1923, at 10:30 o'clock in the forenoon of that day, or as soon thereafter as counsel can be heard for an order confirming the report of Hon. John J. Townsend, Referee in Bankruptcy, dated June 11, 1923, and filed with this Court, and for such other and further relief as may be just, proper and equitable in the premises.

Dated, New York, June 14, 1923.

Robert P. Levis, Attorney for Trustee.

Office and Post Office Address, 42 Broadway, Borough of Manhattan, City of New York.

To William Hayward, United States District Attorney, Attorney for U. S. Government, Post Office Building, Manhattan.

[fol. 34] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER OF REFEREE

Upon the proof of claim heretofore filed herein by Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, on behalf of the United States of America, on November 25, 1922, and refiled on March 15, 1923, for the sum of $11,523.30 with interest from January 22, 1922, to date of payment, against Abraham Finkelstein individually and against the [fol. 35] co-partnership of Finkelstein Brothers; the petition of Henry H. Kaufman, the trustee herein, verified February 23, 1923, and the order to show cause issued thereon by Referee John J. Townsend on February 26, 1923; and hearings and due deliberation having been had thereon, and the opinion of the Referee having been heretofore duly filed herein, it is, on motion of Robert P. Levis, Esq., attorney for the Trustee,

Ordered that the claim filed herein as aforesaid by Frank K. Bowers as Collector of Internal Revenue for the Second Collection District of New York be allowed as a claim against the individual assets of the bankrupt Abraham Finkelstein coming into the hands of the trustee herein, and it is further

Ordered that the trustee herein apply the assets of said co-partnership of Finkelstein Brothers coming into his hands toward the payment of said claim only after the payment in full of the claims of all creditors of said copartnership of Finkelstein Brothers.

J. J. Townsend, Referee.

[fol. 36] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION TO REVIEW

To John J. Townsend, Esq., referee in bankruptcy:

The petition of Victor House, Assistant United States Attorney for the Southern District of New York, respectfully alleges:

That Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, is the creditor of Abraham Finkelstein, one of the above named bankrupts, for balance of income tax for the year 1919 in the sum of $11,523.30, and claims to be entitled to payment of said claim out of the partnership assets of Finkelstein Brothers prior to the payment of general co-partnership creditors; that the claim of the said Frank K. Bowers as such Collector has been duly filed herein; that on the 24th day of August, [fols. 37 & 38] 1923, an order of which a copy is hereto annexed was duly made and entered herein postponing payment of said claim

until after the payment of partnership creditors of the above named partnership in full.

That such order is erroneous in that the same is contrary to the evidence, the weight of the evidence and contrary to law.

Wherefore, your petitioner respectfully asks that the said order may be reviewed as provided in the bankruptcy law of 1898 and general order XXVII.

Dated, New York, August 29, 1923.

Victor House, Petitioner.

Jurat showing the foregoing was duly sworn to by Victor House omitted in printing.

[fol. 39] IN UNITED STATES DISTRICT COURT

[Title omitted]

REFEREE'S CERTIFICATE

To the Honorable Judges of the District Court of the United States for the Southern District of New York:

I, John J. Townsend, Referee in charge of this case, do hereby certify that in the course of the proceedings had before me herein, the following question arose pertinent to the proceedings:

On March 15, 1923, the Collector of Internal Revenue filed with me a proof of claim, asserting a claim against Abraham Finkelstein for an unpaid balance of Income Tax for the year 1919, amounting to $11,523.30. Priority in payment before all claims, together with interest at one per cent. per annum until paid, beginning January [fol. 40] 22, 1922, was also asserted.

The Trustee, on his petition, obtained an order to show cause dated February 26, 1923, requiring the Collector of Internal Revenue to show cause why an order should not be made decreeing that the above claim is a claim against the individual estate of Abraham Finkelstein and is not to be paid out of the partnership assets in which the individual estate of Abraham Finkelstein has no interest or equity within subd. (f) of §5 of the Bankruptcy Act.

Proceedings were thereupon had before me, as shown by the accompanying stenographer's minutes, consisting of 20 pages.

There is also to be considered as part of the evidence the stipulation filed with me August 24, 1923, to the effect that the income of the bankrupt Abraham Finkelstein upon which the tax claim herein was based, was derived from the business of the co-partnership of Finkelstein Brothers.

After due consideration, I made a Report to this Court, dated June 11, 1923, and on August 24, 1923, I filed an order to the effect that the claim aforesaid be allowed as a claim against the individual assets of the bankrupt Abraham Finkelstein coming into the hands

of the Trustee, and that the Trustee apply the assets of the bankrupt copartnership of Finkelstein Brothers coming into his hands toward the payment of said claim only after the payment in full of the claims of all creditors of said copartnership of Finkelstein Brothers.

On August 30, 1923, the Collector of Internal Revenue feeling aggrieved at my order of August 24, 1923, filed with me his petition for review, which was granted.

[fol. 41] The question presented on this review is whether the Referee was correct in deciding that the claim filed for Income Tax for the year 1919 of Abraham Finkelstein should be allowed as a claim against the individual assets of the bankrupt Abraham Finkelstein, and that the Trustee apply the assets of the copartnership of Finkelstein Brothers coming into his hands toward the payment of said claim only after the payment in full of the claims of all creditors of said copartnership of Finkelstein Brothers.

I hand up herewith for the information of the Judges, the following papers:

(1) Proof of claim, filed March 15, 1923, at $11,523.30.
(2) Order to show cause and Petition of Trustee, filed March 14, 1923.
(3) Stenographer's minutes, pages 1-20.
(4) Report of Referee on above claim, filed June 12, 1923.

N. B.—The papers (1) to (4), inclusive, are attached to the Referee's Report, filed June 12, 1923, in the office of the Clerk.

(5) Stipulation, filed August 24, 1923.
(6) Order on claim, filed August 24, 1923.
(7) Petition for review, filed August 30, 1923.

New York, October 2, 1923.

J. J. Townsend, Referee in Bankruptcy.

[fol. 42] IN UNITED STATES DISTRICT COURT

[Title omitted]

NOTICE OF MOTION TO SET ASIDE REFEREE'S ORDER

SIR: Please take notice that upon the proceedings heretofore had herein, the undersigned will move this Court at a term thereof for motions to be held in Room 235 of the United States Courts and Post Office Building at Broadway and Park Row in the Borough of Manhattan, City and Southern District of New York, on the 5th day of September, 1923, at 10:30 o'clock in the forenoon of that day or as soon thereafter as counsel can be heard, for an order vacating and setting aside the order of Referee John J. Townsend herein dated August 24th, 1923, postponing the payment of the claim filed by Frank K. Bowers, Collector of Internal Revenue for the Second Dis-
[fol. 43] trict of New York, on behalf of the United States of

America, against Abraham Finkelstein, one of the above named bankrupts, out of the partnership assets coming into the hands of the trustee herein until after the payment of partnership creditors in full, and for an order directing the payment of said claim out of said partnership assets prior to the payment of co-partnership creditors, and for such other and further relief as may be proper.

Dated, New York, August 29, 1923.

Yours, etc., William Hayward, United States Attorney for the Southern District of New York, Attorney for Frank K. Bowers, Collector of Internal Revenue, etc.

To Robert P. Levis, Esq., Attorney for Trustee, 42 Broadway, New York City.

[fol. 44] IN UNITED STATES DISTRICT COURT

[Title omitted]

JUDGMENT—Filed Oct. 22, 1923

This matter having come on to be heard, and after hearing Victor House, Esq., of counsel for Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, in support of a motion to reverse the order of Referee John J. Townsend dated August 24, 1923, and Max E. Sanders, of counsel for Henry H. Kaufman, Trustee in Bankruptcy, in opposition thereto, it is

Ordered that the order of John J. Townsend, Esq., Referee in Bankruptcy in this proceeding, dated August 24, 1923, be and it hereby is in all respects affirmed.

Learned Hand, U. S. D. J.

[fol. 45] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION FOR AND ORDER ALLOWING APPEAL

To the Honorable the Judges of the United States District Court for the Southern District of New York:

The United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, feeling aggrieved by the order and decree of the United States District Court for the Southern District of New York, made by the Honorable Learned Hand, one of the Judges thereof, and entered herein on the 22nd day of October, 1923, in the above entitled proceeding, affirming an order of John J. Townsend, Esq., Referee in

Bankruptcy, dated August 2, 1923, allowing the claim filed herein by Frank K. Bowers, Collector of Internal Revenue for the Second [fol. 46] District of New York on behalf of the United States, on November 25, 1922, and refiled on March 15, 1923, for the sum of $11,523.30 with interest from January 22, 1922, to date of payment, as a claim against the individual assets of the bankrupt Abraham Finkelstein, but directing that the trustee apply the assets of the co-partnership of Finkelstein Brothers, coming into his hands, toward the payment of said claim, only after the payment in full of the claims of all creditors of the said copartnership of Finkelstein Brothers, instead of directing the payment of said claim out of the assets of said copartnership prior to the payment of co-partnership creditors, do hereby petition for an appeal upon the said order and decree, to the United States Circuit Court of Appeals for the Second Circuit, to do and receive what may appertain to justice to be done in the premises, and that a transcript of the record, proceedings and evidence in said proceeding, duly authenticated, may be transmitted to the United States Circuit Court of Appeals for the Second Circuit.

Dated, New York, October 24, 1923.

United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, by William Hayward, United States Attorney for the Southern District of New York.

The foregoing appeal is hereby allowed.

L. Hand, U. S. D. J.

[fol. 47] IN UNITED STATES DISTRICT COURT

[Title omitted]

NOTICE OF APPEAL

SIRS: Please take notice that the United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, hereby appeal from the order and decree of the United States District Court for the Southern District of New York, made by Honorable Learned Hand, one of the Judges hereof, and entered herein on the 22nd day of October, 1923, affirming an order of John J. Townsend, Esq., Referee in Bankruptcy, dated August 24, 1923, whereby the claim filed herein by Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, on behalf of the United States of America, on November 25, 1922, and refiled on March 15, 1923, for the sum of $11,523.30, with interest from January 22, 1922, to date of payment, against Abra- [fol. 48] ham Finkelstein, individually and against the co-partnership of Finkelstein Brothers, was allowed as a claim against the in-

dividual assets of the bankrupt Abraham Finkelstein, but not allowed as a claim against the copartnership of Finkelstein Brothers, until after the payment of the claims of all the creditors of the said co-partnership in full, to the Circuit Court of Appeals for the Second Circuit, to be held in and for the said Circuit at the United States Courts and Post Office Building, in the Borough of Manhattan, City of New York.

Dated, New York, October 23, 1923.

Yours, etc., William Hayward, United States Atorney for the Southern District of New York, Attorney for United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York.

Office and P. O. Address, U. S. Courts and P. O. Bldg., Borough of Manhattan, City of New York.

To Robert P. Levis, Esq., Attorney for Trustee, 42 Broadway, New York City; Alexander Gilchrist, Jr., Esq., Clerk of the District Court of the United States for the Southern District of New York.

[fol. 49] IN UNITED STATES DISTRICT COURT

[Title omitted]

ASSIGNMENT OF ERRORS

Now come the United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York and file the following assignment of errors:

1. That the United States District Court for the Southern District of New York erred in affirming the order herein of John J. Townsend, Esq., Referee in Bankruptcy, dated August 24, 1923.

[fol. 50] 2. That the said Court in its order dated October 22, 1923, affirming the order of said John J. Townsend, Esq., Referee in Bankruptcy, dated August 24, 1923, erred in failing to allow the claim filed herein by Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, on behalf of the United States of America, on November 25, 1922, and refiled on March 15, 1923, for the sum of $11,523.30 with interest from January 22, 1922, to date of payment, as a priority claim to be paid out of the assets of the co-partnership of Finkelstein Brothers coming into the hands of the trustee herein, prior to the payment of the claims of general copartnership creditors.

Wherefore, the United States of America prays that the said order and decree herein for the manifest errors aforesaid, and for other errors in the record and proceedings herein, may be reversed and

for naught held and esteemed; and that it may be restored to all matters and things which it has lost by reason of said order and decree, and that the United States District Court for the Southern District of New York may be directed to enter an order and decree herein allowing said claim of the United States of America as filed, as a priority claim against the copartnership assets of Finkelstein Brothers coming into the hands of the trustee herein, in advance of the payment of dividends to general copartnership creditors.

Dated, New York, October 24, 1923.

William Hayward, United States Attorney for the Southern District of New York.

[fol. 51] CITATION—In usual form; omitted in printing

[fol. 52] IN UNITED STATES DISTRICT COURT

[Title omitted]

STIPULATION RE TRANSCRIPT OF RECORD

It is hereby stipulated and agreed that the foregoing is a true transcript of the record of the U. S. District Court for the Southern District of New York, in the above-entitled matter, as agreed upon by the parties.

Dated, New York, December 19, 1923.

Robert P. Levis, Attorney for Henry H. Kaufman, Trustee. Wm. Hayward, United States Attorney for the Southern District of New York, Attorney for United States of America and Frank K. Bowers, Collector.

[fol. 53] IN UNITED STATES DISTRICT COURT

[Title omitted]

CLERK'S CERTIFICATE

I, Alexander Gilchrist, Jr., Clerk of the District Court of the United States of America for the Southern District of New York, do hereby certify that the foregoing is a correct transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, this 21st day of December, in the year of our Lord one thousand nine hundred and twenty-three and of the Independence of the said United States the one hundred and forty-eighth.

Alex. Gilchrist, Jr., Clerk.

38854.

[fol. 54] In United States Circuit Court of Appeals for the Second Circuit, October Term, 1923

Nos. 267-338

Argued March 17, 1924. Decided April 7, 1924

In the Matter of Abraham Finkelstein, Israel Finkelstein, and Nettie Finkelstein, Individually and as Copartners, Trading as Finkelstein Bros., Bankrupts

Re Claim of Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, for $11,523.30

United States of America and Frank K. Bowers, as Collector of Internal Revenue for the Second District of New York, Appellant,

v.

Henry H. Kaufman, Trustee in Bankruptcy, Appellee

In the Matter of Jones & Baker, Alleged Bankrupts

Appeal from the District Court of the United States for the Southern District of New York

Before Rogers, Hough, and Mayer, Circuit Judges

Opinion

These two appeals were argued at the same time and will be disposed of in one opinion.

In the Finkelstein case the District Court for the Southern Dis-[fol. 55] trict of New York affirmed the order of the Referee in bankruptcy allowing the claim of Bowers, Collector against the individual assets of Finkelstein, but not against the partnership assets. The facts are sufficiently set forth in the opinion of Referee Townsend which, because of its careful review of the question litigated, we quote infra.

In the Jones & Baker case, the District Court for the Southern District of New York reached the same conclusion on a different

state of facts, in respect of which, however, there is no difference in principle from what was held in the Finkelstein case.

The facts in the Jones & Baker case may be briefly stated.

Jones & Baker was a partnership composed of two partners, William R. Jones and Jackson B. Sell, and was engaged in the stock brokerage business. On March 31, 1923, an involuntary bankruptcy proceeding was commenced against the firm in the District Court for the Southern District of New York and a receiver was appointed.

An offer of composition in bankruptcy was made by the firm to the partnership customers and creditors, as distinguished from the creditors of the individual partners, which contemplated the valuing of all securities in the margin accounts at their value on May 31, 1923, and the payment to the partnership customers and creditors on the resulting credit balances of at least 90% in cash and securities as so valued. No offer of composition was made to the creditors of the individual partners. This offer of composition was confirmed by the District Court, and the Receiver was directed to carry it into effect. Under the composition the creditors of the firm cannot by any possibility recover the full amount of their claims.

In July, 1923, more than one month after the appointment of the receiver, the government, upon a re-examination of the individual tax returns of the individual partners, for the years 1918, 1919 and 1920, assessed certain additional income taxes against [fol. 56] Jones for $632,768.04 and Sells for $62,661.89. Separate claims for these amounts were thereupon filed with the Receiver, both dated July 14, 1923, by the Collector of Internal Revenue for the Second Collection District of New York.

These two claims were entitled in the bankruptcy proceedings and were specifically stated to be against the individuals.

Subsequently separate amended claims in identical language were filed with the Receiver for slightly reduced amounts.

As the result of negotiations, a formal stipulation was entered into under date of November 26, 1923, between the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and Jones, by which the amount of his income tax liability for the years 1918, 1919 and 1920 was reduced to $273,739.07. Under the same date a similar stipulation was entered into with Sells reducing his net additional income tax liability for the same years to $5,518.41.

These stipulations were entered into separately with each partner, and each stipulation fully recites the facts relating to the individual assessment concerned.

The Government, however, has endeavored in the bankruptcy proceeding to assert these claims as claims against the assets of the firm of Jones & Baker, collected and held by the Receiver for the use and benefit of the creditors of the firm and has endeavored to enforce the two claims as being entitled to payment out of the firm's assets prior to the customers and creditors of the firm.

The opinion of the Referee in the Finkelstein case follows:

"The Collector's claim * * * asserts a claim against Abraham Finkelstein for an unpaid balance of Income Tax for the year 1919, the balance being stated at $11,523.30. Priority in payment [fol. 57] before all claims, together with interest at 1% per month until paid beginning January 22, 1922, is also asserted.

The question of priority and of rate of interest will be reserved by the Referee for the present.

The entire Income Tax for the year 1919 asserted against Abraham Finkelstein is $15,364.40 of which he appears to have paid the instalment or one-fourth normally falling due in March, 1920, at $3,841.10. The remaining three instalments or three-fourth- aggregating $11,523.30 form the basis of the present claim.

On October 14, 1920, a petition in bankruptcy was filed against the partnership and the partners upon which petition the three partners individually and as a partnership was adjudicated on April 1, 1921.

It does not appear that the Collector prior to the filing of the petition in bankruptcy in October, 1920, ever took any steps against Abraham Finkelstein to collect the unpaid instalments of June 15, 1920, and September 15, 1920, either against the individual property of Abraham Finkelstein, including his interest in the partnership at that time.

At the hearing it appeared that all the assets in the hands of the Trustee in Bankruptcy are partnership assets and that the Trustee has no assets otherwise the property of Abraham Finkelstein. It was conceded Abraham Finkelstein had a substantial interest in any surplus of partnership assets remaining after paying partnership debts. It is however conceded that in this there is no surplus.

At the hearing the government contended that the Collector's claim was payable out of the partnership assets prior to the payment of the general copartnership creditors.

At the hearing the Trustee contended that the government's claim was only payable out of any individual assets (of which in this case [fol. 58] there were none) belonging to the individual estate of Abraham Finkelstein within subdiv. f of Section 5 of the Bankruptcy Act.

In other words, the Government's contention is that the tax assessed against Abraham Finkelstein should be paid out of the partnership assets prior to partnership creditors the same as if the Income Tax had been assessed upon the partnership as an entity as was the case under the Revenue Act of 1917; see Title II, Section 201 of that statute which reads as follows:

"That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereafter in this title referred to as the tax) equal to the following percentages of the net income. * * *"

It is to be noted that Title I of the Act of 1917 imposes an Income Tax upon the income of every individual and that Title II of the Act imposes a graduated excess profits tax on a partnership as an entity.

The Revenue Act of 1918 under which the present tax was imposed upon Abraham Finkelstein was a departure from the plan of the Revenue Act of 1917 in not imposing a tax upon a partnership as an entity but declaredly imposed the tax upon the partner in his individual capacity and in respect to the income, whether distributed or not, which he was entitled to receive from the partnership.

The language of the statute is as follows:

'Sec. 218 (a). That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner [fol. 59] his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed.'

'Sec. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.'

It is also to be noted that these sections are found in Part II of the Revenue Act of 1918 entitled 'Part II—individuals.'

In my opinion the sovereign in the Act quoted has publicly declared its claim against the taxpayer and that the language of the statute, viz.; Section 218 (a) impliedly, if not expressly, follows or adopts the rule of marshalling laid down in subdiv. f of Section 5 of the Bankruptcy Act.

Had the partnership remained solvent and had the Collector pursued Abraham Finkelstein for the unpaid Income Tax the maximum right of the Government, in my opinion, under the statute would have been to pursue the individual assets of Abraham Finkelstein and to have pursued the latter's interest in the partnership after its affairs were marshalled under the familiar rule.

[fol. 60] I find nothing in Sections 3186 and 3466 or 3467 of the revised statutes of the United States which increases the res which the Collector may seize. Those three sections read as follows:

'If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United

States from the time when the assessment list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon all property and rights to property belonging to such person; * * *.'

'Sec. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied, and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.'

'Sec. 3467. Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.'

[fol. 61] Neither of these three sections attempts to define the assets of the taxpayer which are subject to seizure.

In my opinion the insolvency of the partnership or the partner who is the taxpayer does not increase the rights of the Government.

In other words I do not believe, because the partnership and the individual partners have become insolvent, that for that reason the Government to satisfy an unpaid tax imposed upon one partner as an individual can seize all the assets of the partnership in advance of the creditors of the partnership.

Non constat but that had the Government acted promptly in 1920 it might have secured from Abraham Finkelstein payment of at least two of the instalments of the tax out of his individual assets including his equity in the partnership.

The fact that the Government delayed collection until after such equity had disappeared and any other assets of Abraham Finkelstein had also disappeared affords no reason why the partnership assets, which otherwise would have belonged to the partnership creditors, should be now seized by the Government to pay its claim against Abraham Finkelstein as an individual under Section 218 (a) of the Revenue Act of 1918.

I repeat that the present controversy cannot be decided correctly without constantly keeping in mind the text of Sections 218 and 224 of the Revenue Act of 1918 quoted above.

Congress having deliberately chosen the plan of taxation indicated in those sections, instead of assessing the income of the partnership as an entity and making the tax thereby payable out of partnership assets in the first instance in case of a failure, the Col-

[fol. 62] lector is precluded from asserting the different rule here contended for by him, even if (as he points out) the statutory plan works (as here) to leave the partnership assets to the partnership creditors free from seizure to satisfy a tax imposed on one partner 'in his individual capacity.'

I read the following cases as supporting the views expressed in this memorandum:

U. S. v. Hack, 8 Peters, 271;
U. S. v. Evans, Crabbe, 60; 2 Fed. Cases, #15062.

The Collector relies on the following cases:

In re Straussberger, 4 Wood, 557, 23 Fed. Cases, #13526;
Lewis v. U. S., 92 U. S., 618.

In the Straussberger cases the United States had recovered a judgment on a whiskey bond against both of the Straussbergers who were partners in a whiskey business but who had each executed the bond in connection with that business in their individual capacities. It is evident to me that this feature was decisive of the case. The language at page 559, postponing the claims of partnership creditors as well as of separate creditors to the claims of the United States, must be read in connection with the limitation in the language of the opinion on page 558, beginning 'When the United States have a claim against one member of a firm and not against the other its priority extends only to the interest of that member, etc., etc.'

I cannot read the Lewis case as impairing the prior decision of the U. Supreme Court in U. S. v. Hack. The facts were as follows:

The United States had a claim against the partnership of Jay [fol. 63] Cook McCulloch & Co. of London, hereafter called the English firm.

On November 26, 1873, the American firm became bankrupt and Lewis was the Trustee in Bankruptcy.

The United States asserted against the Trustee in bankruptcy a claim against separate estates of the seven American partners in the American firm, they being partners in the English firm which was primarily the debtor to the United States.

The Supreme Court merely decided that the United States holding a claim primarily against the English partnership was not bound to go into a foreign jurisdiction to assert that claim against that partnership before proceeding against the separate estates of the partners in this country but could assert a claim against the separate estates of the partners so far as found in this country in the possession of Lewis, the Trustee in bankruptcy of the American firm. The decision cannot in my opinion be read as authority for the converse proposition contended for by the Collector, that the United States in holding a claim against a partner as an individual may assert that claim against the partnership assets ahead of the claims of partnership creditors, which is the proposition condemned in U. S. v. Hack, supra.

I report that the Trustee in bankruptcy in this proceeding is entitled to a decree barring the claim of the Collector of Internal Rev-

enue against the partnership assets of Finkelstein Brothers in priority against the claims of the creditors of Finkelstein Brothers.

Such order should contain a provision expressly reserving the rights of the Collector of Internal Revenue against the individual estate of Abraham Finkelstein until it is made to appear that such an estate exists in the hands of the Trustee in Bankruptcy."

[fol. 64] Robert P. Lewis (Max E. Sanders, of Counsel), for Appellee, Henry H. Kaufman, Trustee.

White & Case (Lyle T. Alverson, Alfred C. Coxe, J. M. Hartfield, Henry H. Kaufman, Wm. St. John Tozer and Ralph Wolf, of Counsel), for Receiver Coxe.

William Hayward, U. S. Attorney; Nelson T. Hartson, Solicitor of Internal Revenue, Russell N. Shaw, Special Attorney, Bureau of Internal Revenue, and Victor House, Special Asst. U. S. Attorney, for Appellants.

MAYER, Circuit Judge:

The fundamental fallacy of the contention on behalf of the Government is that it confuses priority with the existence of a fund out of which taxes are payable or collectible.

The authority to tax must be found somewhere. The Revenue Act of 1918, in Section 1400 thereof, specifically repealed, inter alia, Title I including Section 8 (e) of the Revenue Act of 1916 and Title II, including Section 201 of the Revenue Act of 1917.

The provisions of the tax statute here concerned are thus Section 218 (a) and Section 224 of Title II of the Revenue Act of 1918. As pointed out in the opinion of the Referee, supra, there is not the slightest warrant for concluding that the tax was against partnerships and not solely against the "individuals carrying on business in partnerships." The language of Section 218 (a) is too plain for extended discussion and its meaning could be fortified, if necessary, by the contrast between the Revenue Act of 1917 and the Revenue Act of 1918 in this regard.

As, therefore, there was no income tax against the partnership in either of the cases at bar, we must look to the bankruptcy statute to [fol. 65] ascertain whether it affirmatively provided that the tax assessed against the individuals could be proved against the partnership estate. We need not pause to consider what distinction, if any, there is between "debts" and "taxes" in various parts of the Bankruptcy Act. We may also assume for the purpose of the argument that, if the Revenue Act of 1918 authorized assessment of the tax against the partnership instead of against the individuals, it might not have been necessary to name the United States in any provision as to marshalling.

The point, however, is that, as there is no tax against the partnership, the only remaining theory upon which the tax against the individuals can be proved against and recovered out of the partnership estate is that the Bankruptcy Act of 1898 so provided.

Section 5, subdivision (f) of that Act did not so provide. This provision reads:

"The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnerships."

There can be no longer any doubt that the distinction between individual and firm debts is a matter of substance which cannot be disregarded.

[fol. 66] In re Wilcox, 94 F. R., 84;
In re Janes, 133 F. R., 912;
In re Schall v. Camora, 251 U. S., 239;
In re Jarmulowsky, 287 F. R., 703.

There is, of course, no doubt that the right of priority of the United States in the collection of taxes is an attribute of sovereignty.
Marshall v. New York, 254 U. S., 380.

Under Section 64 (a) of the Bankruptcy Act of 1898, it is the duty of the court to order the trustee to pay all taxes, legally due and owing by the bankrupt to the United States, in advance of the payment of dividends to creditors; but, of course, the tax must be "legally due and owing by the bankrupt to the United States."

U. S. R. S., Sections 3186, 3466 and 3467 deal with tax priority, but there is nothing in the provisions of these sections which changes the tax against an individual into a tax against the partnership. Numerous instances will be found in the case of In re Wilson, 252 F. R., 631, which illustrate the difference between the identity of the fund or person against whom a claim can be made and respective priorities once the fund or person is found or determined. If, therefore, the Congress had intended that the tax against the individuals should be paid out of the partnership estate prior to the payment of the partnership debts it would have so declared by some affirmative language to that effect either in section 5 (f) of the statute or in some other provision.

It must be remembered that the Bankruptcy Act of 1898 has now been in operation for a little over a quarter of a century and that business has been done on the faith and basis of the statute. It can [fol. 67] readily be seen that a partnership might not be able to obtain the same amount of credit from banks and other lending sources if in marshalling the assets of a partnership, such assets become a fund out of which the debts or taxes due and owing from the individual members are payable prior to or pari passu with the partnership debts.

As pointed out by Judge Rogers in United States v. Wood, 290 F. R., 109, there is a marked difference between the Act of 1898

and previous acts in respect of the relation of the United States to the present bankruptcy act. In the case just cited, there is a review of many cases illustrative of this proposition. It is hard to believe, in view of the definite language of Section 5 (f) that the legislature intended to create a situation where the debts or taxes due from the individuals might either wipe out or share with the debts due from the partnership; for any such provision might well have been most detrimental to business and commerce. Of course, it is always within the power of the Congress to tax the partnership as distinguished from the individuals, but where, as here, no such tax exists, we confess that we are unable to find anywhere in the Bankruptcy Act of 1898 any provision which authorizes the collection of the tax from property which was never taxed.

United States v. Hack, 8 Peters, 271;
United States v. Evans, 25 Fed. Cases, 1023.

The cases of Lewis v. United States, 92 U. S., 618, and In re Strassburger, 23 Fed. Case, 224, have been analyzed in the opinion of the Referee and the Lewis case has been further commented upon in the Wood case, supra, at pages 111 et seq.

Our attention has been called to a decision of the District Court of New Jersey in the Matter of Brezin & Schaefer, not reported. We are unable to agree with this decision. (Note.) There is nothing

[fol. 68] in the record of either of the cases at bar upon which an equitable lien against the partnership assets may be asserted in favor of the United States. "Equitable lien" is often used synonymously with "equitable assignment" and "impressing a trust." An excellent definition is found in Lighthouse v. Third National Bank, 162 N. Y., at page 344:

"One of the first essentials to the creation of an equitable lien is the specific thing or property to which it is to attach.

Though possession is not necessary to the existence of an equitable lien, it is necessary that the property or funds upon which the lien is claimed should be distinctly traced, so that the very thing which is subject to the special charge may be proceeded against in an equitable action and sold under decree to satisfy the charge."

See also,

Pomeroy on Equity, Fourth Edition, Vol. 3, Section 1233;
Bispham on Equity, 4th Edition, Sec. 351;
Ketchum v. St. Louis, 101 U. S., 306;
Walker v. Brown, 165 U. S., 654;
National City Bank v. Hotchkiss, 231 U. S., 50, 57;
In re National Cash Register Co., 174 F. R., 579;
In re See, 209 F. R., 172.

(Note)—See interesting article in Columbia Law Review, April, 1924, entitled "The Priority of the United States in the Payment of its Claims against a Bankrupt" by Ralph F. Colin, at pages 360, 371 and 372.

Every element of an equitable lien is absent in each of the cases here under consideration.

Finally, there is no merit in the suggestion that the marshalling provisions are not applicable in the Jones & Baker case because there the composition in that case was had before adjudication. The composition was only with the partnership creditors and there was no [fol. 69] composition with the creditors of the individual partners. This was warranted by Section 12 of the Bankruptcy Act, as amended June 25, 1910. In re Breitbart, 291 F. R., 693.

A composition whether before or after adjudication, so far as affects the questions here presented, stands in the same position as a liquidation through a trusteeship in bankruptcy. (See opinion of Referee Remington, Matter of Simon Fox, 6 A. B. R., 525, 530.)

It is plain that under the Bankruptcy Act, it is intended that its administrative sections shall apply whichever method of administration ma ybe chosen.

We think it unnecessary to comment in detail upon many cases cited in the briefs. It is sufficient to observe that three cases upon which some emphasis is laid by appellant, i. e., Matter of Menist, 294 F. R., 532, U. S. v. McHatton, et al., 266 F. R., 602 and Titus v. Maxwell, 281 F. R., 433, either are not relevant to the question here under consideration or contain nothing to disturb the conclusion that the decrees below were correct.

Decrees affirmed.

[fols. 70 & 71] In United States Circuit Court of Appeals

[Title omitted]

Judgment—Filed April 14, 1924

Appeal from the District Court of the United States for the Southern District of New York

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Southern District of New York and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed.

H. W. R.
J. M. M.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

[fol. 72] In United States Circuit Court of Appeals

Clerk's Certificate

I, William Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby Certify that the foregoing pages, numbered from 1 to 71 inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of In the Matter of Abraham Finkelstein et al., Individually, etc., Bankrupts; Frank K. Bowers, as Collector, etc., Appellant, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this 23rd day of June in the year of our Lord One Thousand Nine Hundred and twenty-four and of the Independence of the said United States the One Hundred and forty-eighth.

William Parkin, Clerk. (Seal of United States Circuit Court of Appeals, Second Circuit.)

[fol. 72a] In Supreme Court of the United States

On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

Order Granting Petition for Certiorari—Filed Oct. 13, 1924

On consideration of the petition for a writ of certiorari herein to the United States Circuit Court of Appeals for the Second Circuit, and of the argument of counsel thereupon had, as well in support of as against the same, it is now here ordered by this Court that the said petition be, and the same is hereby, granted, the record already on file as an exhibit to the petition to stand as a return to the writ.

[fol. 73] In United States District Court, Southern District of New York

No. 34907

In the Matter of the Petition of Clyde W. Pope, Joseph M. Williams, Robert S. Dodge to Have the Firm of Jones & Baker and William R. Jones and Jackson B. Sells, Doing Business as Copartners under the Firm Name and Style of Jones & Baker, Individually and as Members of the Firm of Jones & Baker, Adjudicated Bankrupts

Order to Show Cause

Upon the annexed affidavit of Alfred C. Coxe, Jr., as Receiver, it is Ordered, that the United States show cause before me at Courtroom 2, in the Woolworth Building, on the 19th day of December, 1923, at 2:30 o'clock in the afternoon of said day, why an order should not be entered herein disallowing and expunging as claims against the estate and assets of the firm of Jones & Baker, the claim of $273,739.07 for income tax assessed against William R. Jones and the claim of $5,518.41 for income tax assessed against Jackson B. Sells; service of a copy of this order on the Collector of Internal Revenue for the Second District of New York and upon the United States Attorney for the Southern District of New York on or before the 17th day of December, 1923, shall be sufficient.

Henry W. Goddard, U. S. D. J.

[fol. 74] In the United States District Court

[Title omitted]

Affidavit of Alfred C. Coxe, Jr.

Alfred C. Coxe, Jr., being duly sworn, says:

I. That on the 31st day of May, 1923, he was duly appointed Receiver herein.

II. That claims for $273,739.07, representing income tax assessed against William R. Jones, and for $5,518.41 representing income tax assessed against Jackson B. Sells, have been filed, on behalf of the United States, with deponent as Receiver and are asserted to be claims against the assets of the firm of Jones & Baker, and the said partnership estate.

[fol. 75] III. That the actual realizable value of the assets of the firm of Jones & Baker which have come into the possession of depo-

nent as Receiver are now insufficient in amount to pay in full all of the allowable claims of creditors of said partnership estate.

IV. That the tax upon which said claims are based was assessed against said William R. Jones and said Jackson B. Sells, as individuals.

Wherefore, deponent asks that said claims be disallowed and expunged as claims against the estate and assets of the firm or partnership of Jones & Baker, and that an order to show cause be issued directing the United States to show cause why said claims should not be disallowed and expunged, and for such other and further relief as may be proper.

Alfred C. Coxe, Jr.

Sworn to before me this 14th day of December, 1923. James McCarron, Notary Public, Kings Co., No. 24. Certificate filed New York Co. (Seal.)

[fol. 76] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT IN SUPPORT OF MOTION TO EXPUNGE INCOME TAX CLAIMS

STATE OF NEW YORK,
County of New York, ss:

Alfred C. Coxe, Jr., being first duly sworn on oath, says that on the 26th day of November, 1923, an offer of composition in bankruptcy, dated November 23, 1923, was made and filed in this Court on behalf of the said above mentioned bankrupts, a copy of which offer is hereto annexed, marked "Exhibit A," and made a part of this affidavit, and that a motion to confirm said offer has been duly made and is now pending in this Court.

That on or about the 30th day of July, 1923, the Collector of Internal Revenue for the Second Collection District of New York filed a claim, dated July 14, 1923, against this estate for taxes against [fol. 77] William R. Jones in the sum of $632,768.04, and a claim dated July 14, 1923, for taxes against Jackson B. Sells in the sum of $62,661.89. That subsequently, and under date of November 26, 1923, the Secretary of the Treasury and the Collector of Internal Revenue of the United States entered into a stipulation and agreement with William R. Jones, and a stipulation and agreement with Jackson B. Sells, in respect of said above mentioned claims, copies of which said two stipulations and agreements are hereto annexed, marked "Exhibits B" and "C," respectively, and made a part of this affidavit.

That under and in accordance with such stipulations and agreements above referred to, the claim against the said Jones has been reduced to $273,739.07, and the claim against the said Sells has been reduced to $5,518.41.

This affidavit is submitted on the motion made by deponent for the disallowance and expunging of the claims of the United States Government against the estate and assets of the firm of Jones & Baker on account of taxes of said Jones and Sells above referred to, and for an order directing the United States to show cause why such claim should not be disallowed and expunged.

Alfred C. Coxe, Jr.

Sworn to before me this 9th day of January, 1924. James McCarron, Notary Public, Kings County, No. 24. Certificate filed — New York Co., No. 110. Register's Nos., Kings, 4022, N. Y., 4099. Commission expires March 30, 1924. (Seal.)

[fol. 78] EXHIBIT A TO AFFIDAVIT

[Title omitted]

To the Honorable Judges of the District Court of the United States for the Southern District of New York and the creditors of the above-named alleged bankrupts:

The undersigned, William R. Jones and Jackson B. Sells, individually and as members of the firm of Jones & Baker, and the firm of Jones & Baker, being persons against whom an involuntary petition for adjudication in bankruptcy was heretofore filed herein in this Court, and the schedules of property and list of creditors of which [fol. 79] said individuals and firm have been duly filed in this Court, do hereby offer to the partnership customers and creditors of the firm of Jones & Baker under and pursuant to the Acts of Congress relating to Bankruptcy, and all amendments thereto, now in force, the following Plan of composition:

I. The claims of customers and creditors of the firm of Jones & Baker shall be liquidated by giving the securities, if any, in their respective accounts, the value of the prices obtainable at the close of business on May 31, 1923. All claims shall be paid upon such liquidated basis, and to effect such payment there shall be available when the composition is made operative, cash and New York Curb Market and New York or Chicago Stock Exchange securities, so valued of an aggregate amount and value equal to the aggregate amount of at least 90% of such claims so liquidated.

II. Payment shall be made as follows:

(a) Payment from Cash. Cash shall be paid to each of such customers or creditors of the firm of Jones & Baker in an amount of at

least 50% of their respective claims so liquidated, which cash shall be made available to customers and creditors of the firm of Jones & Baker upon entry of the order confirming the composition;

(b) Payment from securities. The difference between the aggregate of payments from cash to be made under paragraph (a) hereof and the aggregate of all claims so liquidated, shall be represented by securities dealt in or listed on May 31, 1923, on the New York Curb [fol. 80] Market and on the New York or Chicago Stock Exchanges, having, in the aggregate, a value (at the prices obtainable at the close of business on May 31, 1923), equal to such difference; or such cash and securities valued as above provided shall aggregate in amount and value at least 90% of all such claims so liquidated. Such securities (in the possession of the Receiver when the composition is made effective), shall be sold as and when the Receiver may elect and the proceeds of sale of all such securities shall be paid pro rata to such customers and creditors of the firm of Jones & Baker according to their respective credit balances so liquidated, and without deduction of any kind other than the usual brokerage commission to be paid in effecting the sales. The time and method of such sales and the distribution of proceeds shall be provided for in the order confirming the composition.

III. Jones & Baker shall pay, or cause to be paid, all the expenses of administration and of liquidation (other than the brokerage commission mentioned in paragraph [b] of II hereof) and all the expenses of the composition and of the Customers' and Creditors' Committee, and the fees of all counsel as fixed by the Court when the plan of composition or settlement shall have been confirmed.

Dated, New York, November 23, 1923.

William R. Jones, Jackson B. Sells, Individually and as Members of the Firm of Jones & Baker. Jones & Baker, by William R. Jones.

[fol. 81] EXHIBIT B TO AFFIDAVIT

Agreement

This Agreement, made this 26th day of November, 1923, under and in pursuance of Section 1312 of the Revenue Act of 1921, by and between William R. Jones (hereinafter referred to as the taxpayer), residing at New York City, New York, and the Commissioner of Internal Revenue (hereinafter referred to as the Commissioner), with the approval of the Secretary of the Treasury, Witnesseth:

Whereas, on or about the eleventh day of July, 1923, there was a determination by the Commissioner that the sum of $534,149.42 was the correct amount of net additional income taxes for the calendar years 1918, 1919 and 1920, under the provisions of the Act of Feb-

ruary 24, 1919, and the provisions of the Act — November 23, 1921, for which the taxpayer was liable, and

Whereas, on or about the fifteenth day of November, 1923, there was a final determination by the Commissioner that the net additional income tax liability of the said William R. Jones, for the years 1918, 1919 and 1920, is the principal sum of $273,739.07 (exclusive of any interest and penalties), and same was duly assessed, and

Whereas, the taxpayer has accepted an abatement of $260,410.35 from previous assessments made in arriving at said outstanding balance of $273,739.07.

Now, therefore, the taxpayer and the Commissioner, with the ap- [fol. 82] proval of the Secretary of the Treasury, hereby mutually agree that the sum of $273,739.07 is the correct amount of the principal additional tax (exclusive of interest and penalties), for which the taxpayer was and is liable on account of his income tax for the years 1918, 1919 and 1920, and that said sum is final and conclusive, as provided in Section 1312 of the Revenue Act of 1921.

In testimony whereof the parties to this agreement have hereunto set their hands and seals in duplicate.

William R. Jones, Taxpayer. (L. S.) Alfred C. Coxe, Jr., Receiver for Taxpayer. (L. S.) D. W. Blair, Commissioner of Internal Revenue. A. W. Mellon, Secretary of the Treasury, M. M.

R. D. Wilson, Notary Public, New York County, No. 268. N. Y. County Register's No. 4182. Commission expires March 30, 1924.

[fol. 83] EXHIBIT C TO AFFIDAVIT

This agreement made this 26 day of November, 1923, — pursuance of Section 1312 of the Revenue Act of 1921, by and between Jackson B. Sells (hereinafter referred to as the taxpayer), residing at New York City, New York, and the Commissioner of Internal Revenue (hereinafter referred to as the Commissioner) with the approval of the Secretary of the Treasury Witnesseth:

Whereas, on or about the Eleventh day of July, 1923, there was a determination by the Commissioner that the sum of $54,862.02 was the correct amount of net additional income taxes for the calendar years 1918, 1919 and 1920, under the provisions of the Act of February 24, 1919, and the provisions of the Act of November 23, 1921, for which the taxpayer was liable, and

Whereas, on or about the Fifteenth day of November 1923, there was a final determination by the Commissioner that the net additional income tax liability of the said Jackson B. Sells, for the years 1918, 1919 and 1920, is the principal sum of $5,518.41 (exclusive of any interest and penalties), and same was duly assessed, and

Whereas, the taxpayer has accepted an abatement of $49,343.61, from previous assessments made in arriving at said outstanding balance of $5,518.41.

Now, therefore, the taxpayer and the Commissioner, with the approval of the Secretary of the Treasury, hereby mutually agree that the sum of $5,518.41 is the correct amount of the principal additional [fol. 84] tax (exclusive of interest and penalties), for which the taxpayer was and is liable on account of his income tax for the years 1918, 1919 and 1920, and that said sum is final and conclusive, as provided in Section 1312 of the Revenue Act of 1921.

In testimony whereof the parties to this agreement have hereunto set their hands and seals in duplicate.

Jackson B. Sells, Taxpayer. (L. S.) Alfred C. Coxe, Jr., Receiver for Taxpayer. (L. S.) D. W. Blair, Commissioner of Internal Revenue. A. W. Mellon, Secretary of the Treasury. M. M.

R. D. Wilson, Notary Public, New York County, No. 268. N. Y. County Register's No. 4182. Commission expires March 30, 1924.
Approved Dec. 11, 1923.

[fol. 85] IN UNITED STATES DISTRICT COURT

[Title omitted]

STATEMENT OF CLAIMS FOR TAXES DUE THE UNITED STATES

Comes Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, a duly authorized agent for the United States in this behalf, and says that W. R. Jones, Bankrupt, is justly and truly indebted to the United States of America for Internal Revenue Taxes as follows:

Nature of Tax and Statute involved (give Section or Sections).—Income Tax.

Year or taxable period ended.—1920, Wash. July 1923 list. Spec. #7, #945818.

Amount of Tax.—$632,768.04.

That no part of said taxes or interest has been paid but that the same are now due and payable at the office of said Collector of Internal Revenue at Custom House, New York City.

That no security therefor is held by the United States and that there be no set-offs or counter-claims.

[fol. 86] That this claim is entitled to be paid before all other claims, the priority of the United States for the payment of taxes being fully determined by Section 3466 of the Revised Statutes and Section 64 (a) of the Bankruptcy Act.

And attention is hereby called to Section 3467 of the Revised Statutes which provides that every executor, administrator, or assignee, or other person who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall be-

come answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

Dated this 14th day of July, 1923.

Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York.

Sworn to and subscribed before me this 14th day of July, 1923. Arthur I. Perry, Notary Public, New York County. County Clerk's No. 66. Register's No. 4007. Commission expires March 30, 1924. (Seal.)

[fol. 87] IN UNITED STATES DISTRICT COURT

[Title omitted]

AMENDED STATEMENT OF CLAIMS FOR TAXES DUE THE UNITED STATES

Comes Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, a duly authorized agent for the United States in this behalf, and says that W. R. Jones, Bankrupt, is justly and truly indebted to the United States of America for Internal Revenue Taxes as follows:

Nature of Tax and Statute involved (give Section or Sections).—Income Tax.

Year or taxable period ended.—1920—Wash. July 1923, spec. #7 list.

Amount of tax—$534,149.42.

That no part of said taxes or interest has been paid but that the same are now due and payable at the office of said Collector of Internal Revenue at Custom House, New York City.

[fol. 88] That no security therefor is held by the United States and that there be no set-offs or counterclaims.

That this claim is entitled to be paid before all other claims, the priority of the United States for the payment of taxes being fully determined by Section 3466 of the Revised Statutes and Section 64 (a) of the Bankruptcy Act.

And attention is hereby called to Section 3467 of the Revised Statutes which provides that every executor, administrator, or assignee, or other person who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

Dated this 26th day of July, 1923.

Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York.

Sworn to and subscribed before me this 26th day of July, 1923. Arthur I. Perry, Notary Public, New York County. County Clerk's No. 66. Register's No. 4007. Commission expires March 30, 1924.

[fol. 89] IN UNITED STATES DISTRICT COURT

[Title omitted]

STATEMENT OF CLAIMS FOR TAXES DUE THE UNITED STATES

Comes Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, a duly authorized agent for the United States in this behalf, and says that Jackson B. Sells, Bankrupt, is justly and truly indebted to the United States of America for Internal Revenue Taxes as follows:

Nature of Tax and Statute involved (give Section or Sections).—Income Tax.

Year or taxable period ended—1920—Wash. June 1923 List Spec. #3, P. O., L. O. #945815.

Amount of tax—$62,661.89.

That no part of said taxes or interest has been paid but that the same are now due and payable at the office of said Collector of Internal Revenue at Custom House, New York City.

That no security therefor is held by the United States and that there be no set-offs or counterclaims.

[fol. 90] That this claim is entitled to be paid before all other claims, the priority of the United States for the payment of taxes being fully determined by Section 3466 of the Revised Statutes and Section 64 (a) of the Bankruptcy Act.

And attention is hereby called to Section 3467 of the Revised Statutes which provides that every executor, administrator, or assignee, or other person who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

Dated this 14th day of July, 1923.

Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York.

Sworn to and subscribed before me this 14th day of July, 1923. Arthur I. Perry, Notary Public, New York County. County Clerk's No. 66. Register's No. 4007. Commission expires March 30, 1924. (Seal.)

[fol. 91] IN UNITED STATES DISTRICT COURT

[Title omitted]

AMENDED STATEMENT OF CLAIMS FOR TAXES DUE THE UNITED STATES

Comes Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York, a duly authorized agent for the United States in this behalf, and says that Jackson B. Sells, Bankrupt, is justly and truly indebted to the United States of America for Internal Revenue Taxes as follows:

Nature of Tax and Statute involved (give Section or Sections).—Income Tax.

Year or taxable period ended.—1920—Wash. June 1923 list, page O, line O.

Amount of tax—$54,872.02.

That no part of said taxes or interest has been paid but that the same are now due and payable at the office of said Collector of Internal Revenue at Custom House, New York.

[fol. 92] That no security therefor is held by the United States and that there be no set-offs or counterclaims.

That this claim is entitled to be paid before all other claims, the priority of the United States for the payment of taxes being fully determined by Section 3466 of the Revised Statutes and Section 64 (a) of the Bankruptcy Act.

And attention is hereby called to Section 3467 of the Revised Statutes which provides that every executor, administrator, or assignee, or other person who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from his own person and estate for the debts so due to such person or estate, shall become answerable in the United States, or for so much thereof as may remain due and unpaid.

Dated this 26th day of July, 1923.

Frank K. Bowers, Collector of Internal Revenue for the Second Collection District of New York.

Sworn to and subscribed before me this 26th day of July, 1923. Arthur I. Perry, Notary Public, New York County. County Clerk's No. 66. Register's No. 4007. Commission expires March 30, 1924. (Seal.)

[fol. 93] IN UNITED STATES DISTRICT COURT

[Title omitted]

STIPULATION RE PROOF OF PRIORITY OF CLAIM

It is hereby stipulated that if the Court is of the opinion that the question is material whether the taxes herein involved and asserted by the United States as being entitled to priority of payment out of the partnership assets of Jones & Baker are based on partnership income rather than on individual sources of income of the respective partners of Jones & Baker further proof may be offered respecting the sources of the income giving rise to the tax claims herein asserted.

White & Case, Attorneys for Receiver. Wm. Hayward, United States Attorney.

[fol. 94] IN UNITED STATES DISTRICT COURT

MEMORANDUM DECISION—JUDGE GODDARD

(Memorandum Endorsed on Moving Papers)

The question involved herein has been recently passed upon by this Court in the Matter of Finklestein, which decision after examination of the law, I concur in. This motion is accordingly granted.

Henry W. Goddard.

January 23, 1924.

IN UNITED STATES DISTRICT COURT

[Title omitted]

NOTICE OF APPEAL

SIRS: Please take notice that the United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second Dis-[fol. 95] trict of New York, hereby appeal from the order and decree of the United States District Court for the Southern District of New York, made by Honorable Henry W. Goddard, one of the Judges hereof, and entered herein on the 26th day of January, 1924, disallowing and expunging as claims against the estate and assets of the firm of Jones & Baker, the claim of $273,739.07 for income tax assessed against William R. Jones, and the claim of $5,518.41 for income tax assessed against Jackson B. Sells, the individual members comprising the said firm of Jones & Baker, from each and every part of said decree and from the whole thereof to the Circuit Court of Appeals for the Second Circuit to be held in and for the said

Circuit at the United States Courts and Post Office Building in the Borough of Manhattan, City of New York.

Dated, New York, February 4, 1924.

Yours, etc., William Hayward, United States Attorney for the Southern District of New York, Attorney for United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York.

Office & P. O. Address, U. S. Courts & P. O. Bldg., Borough of Manhattan, City of New York.

To White & Case, Esqs., Attorneys for Receiver, 14 Wall Street, New York City; Alexander Gilchrist, Jr., Esq., Clerk of the District Court of the United States for the Southern District of New York.

[fol. 96] IN UNITED STATES DISTRICT COURT

[Title omitted]

ASSIGNMENTS OF ERROR

Now come the United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, and file the following assignment of errors:

1. That the order of the United States District Court for the Southern District of New York, dated and filed the 26th day of January, 1924, is erroneous and contrary to law.

2. That the United States District Court for the Southern District of New York in its said order dated January 26, 1924, erred in disallowing and expunging as claims against the estate and assets of the firm of Jones & Baker the claim of $273,739.07 for income [fol. 97] tax assessed against William R. Jones and the claim of $5,518.41 for income tax assessed against Jackson B. Sells, individual members comprising the said firm of Jones & Baker.

3. That the said Court in its order dated January 26, 1924, erred in refusing to allow the said claim of $273,739.07 for income tax assessed against William R. Jones, and the claim of $5,518.41 for income tax assessed against Jackson B. Sells, the individual members comprising the said firm of Jones & Baker, as priority claims to be paid out of the assets of the said firm of Jones & Baker in advance of payment of the claims of the general creditors of said firm.

Wherefore, the United States of America prays that the said order and decree herein for the manifest errors aforesaid, and for other errors in the record and proceedings herein, may be reversed and for naught held and esteemed; and that it may be restored to all matters and things which it has lost by reason of said order and

decree, and that the United States District Court for the Southern District of New York may be directed to enter an order and decree herein allowing said claims of the United States of America as filed, as priority claims against the firm assets of Jones & Baker entitled to payment in advance of the payment of dividends to general firm creditors.

Dated, New York, February 4, 1924.

William Hayward, United States Attorney for the Southern District of New York.

[fol. 98] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION FOR AND ORDER ALLOWING APPEAL

To the Honorable the Judges of the United States District Court for the Southern District of New York:

The United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, feeling aggrieved by the order and decree of the United States District Court for the Southern District of New York, made by the Honorable Henry W. Goddard, one of the Judges thereof and entered herein on the 26th day of January, 1924, in the above entitled proceeding, disallowing and expunging as claims against the estate and assets of the firm of Jones & Baker, the claim of $273,739.07 for income tax [fol. 99] assessed against William R. Jones, and the claim of $5,518.41 for income tax assessed against Jackson B. Sells, the individual members comprising the said firm of Jones & Baker, whereas the Court should have directed the payment of the aforesaid income tax claims out of the estate and assets of the said firm of Jones & Baker in advance of payment to the creditors of said firm, do hereby petition for an appeal upon the said order and decree to the United States Circuit Court of Appeals for the Second Circuit, to do and receive what may appertain to justice to be done in the premises, and that a transcript of the record, proceedings and evidence in said proceeding, duly authenticated, may be transmitted to the United States Circuit Court of Appeals for the Second Circuit.

Dated, New York, February 4, 1924.

United States of America and Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, by William Hayward, United States Attorney for the Southern District of New York.

The foregoing appeal is hereby allowed.

Henry W. Goddard, U. S. D. J.

[fol. 100] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER DISALLOWING AND EXPUNGING TAX CLAIMS

Upon the petition of Alfred C. Coxe, Jr., receiver herein, the proofs of claim filed with the receiver by the United States Government against William R. Jones and Jackson B. Sells, and the stipulations entered into reducing said claim, and the additional affidavit of said receiver, it is hereby

Ordered that the claims filed herein by the United States for income taxes due from William R. Jones in the amount of $273,739.07, and from Jackson B. Sells in the amount of $5,518.41, be disallowed and expunged as claims against the assets of the firm of Jones & Baker.

Henry W. Goddard, U. S. D. J.

[fol. 101] CITATION—In usual form; omitted in printing

[fol. 102] IN UNITED STATES DISTRICT COURT

[Title omitted]

STIPULATION RE TRANSCRIPT OF RECORD

It is hereby stipulated and agreed that the foregoing is a true transcript of the record of the said District Court in the above entitled matter as agreed on by the parties.

New York, March 13th, 1924.

Wm. Hayward, United States Attorney, Attorney for Appellant. White & Case, Attorneys for Appellee.

[fols. 103 & 104] IN UNITED STATES DISTRICT COURT

[Title omitted]

CLERK'S CERTIFICATE

I, Alexander Gilchrist, Jr., Clerk of the District Court of the United States of America for the Southern District of New York, do hereby certify that the foregoing is a correct transcript of the record of the said District Court in the above entitled matter as agreed on by the parties.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, this 13th day of March, in the year of our Lord one thousand nine hundred and twenty-four and of the Independence of the said United States the one hundred and forty-ninth.

Alexander Gilchrist, Jr., Clerk.

39657.

[fol. 105] In United States Circuit Court of Appeals for the Second Circuit, October Term, 1923

Nos. 267-338

Argued March 17, 1924. Decided April 7, 1924

In the Matter of Abraham Finkelstein, Israel Finkelstein, and Nettie Finkelstein, Individually and as Copartners, Trading as Finkelstein Bros., Bankrupts

Re Claim of Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, for $11,523.30

United States of America and Frank K. Bowers, as Collector of Internal Revenue for the Second District of New York, Appellant,

v.

Henry H. Kaufman, Trustee in Bankruptcy, Appellee

In the Matter of Jones & Baker, Alleged Bankrupts

Appeal from the District Court of the United States for the Southern District of New York

Before Rogers, Hough, and Mayer, Circuit Judges

Opinion

These two appeals were argued at the same time and will be disposed of in one opinion.

In the Finkelstein case the District Court for the Southern Dis-[fol. 106] trict of New York affirmed the order of the Referee in bankruptcy allowing the claim of Bowers Collector against the individual assets of Finkelstein, but not against the partnership assets. The facts are sufficiently set forth in the opinion of Referee Townsend which, because of its careful review of the question litigated, we quote infra.

In the Jones & Baker case, the District Court for the Southern District of New York reached the same conclusion on a different

state of facts, in respect of which, however, there is no difference in principle from what was held in the Finkelstein case.

The facts in the Jones & Baker case may be briefly stated.

Jones & Baker was a partnership composed of two partners, William R. Jones and Jackson B. Sell, and was engaged in the stock brokerage business. On March 31, 1923, an involuntary bankruptcy proceeding was commenced against the firm in the District Court for the Southern District of New York and a receiver was appointed.

An offer of composition in bankruptcy was made by the firm to the partnership customers and creditors, as distinguished from the creditors of the individual partners, which contemplated the valuing of all securities in the margin accounts at their value on May 31, 1923, and the payment to the partnership customers and creditors on the resulting credit balances of at least 90% in cash and securities as so valued. No offer of composition was made to the creditors of the individual partners. This offer of composition was confirmed by the District Court, and the Receiver was directed to carry it into effect. Under the composition the creditors of the firm cannot by any possibility recover the full amount of their claims.

In July, 1923, more than one month after the appointment of the receiver, the government, upon a re-examination of the individual tax returns of the individual partners, for the years 1918, 1919 and 1920, assessed certain additional income taxes against [fol. 107] Jones for $632,768.04 and Sells for $62,661.89. Separate claims for these amounts were thereupon filed with the Receiver, both dated July 14, 1923, by the Collector of Internal Revenue for the Second Collection District of New York.

These two claims were entitled in the bankruptcy proceedings and were specifically stated to be against the individuals.

Subsequently separate amended claims in identical language were filed with the Receiver for slightly reduced amounts.

As the result of negotiations, a formal stipulation was entered into under date of November 26, 1923, between the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and Jones, by which the amount of his income tax liability for the years 1918, 1919 and 1920 was reduced to $273,739.07. Under the same date a similar stipulation was entered into with Sells reducing his net additional income tax liability for the same years to $5,518.41.

These stipulations were entered into separately with each partner, and each stipulation fully recites the facts relating to the individual assessment concerned.

The Government, however, has endeavored in the bankruptcy proceeding to assert these claims as claims against the assets of the firm of Jones & Baker, collected and held by the Receiver for the use and benefit of the creditors of the firm and has endeavored to enforce the two claims as being entitled to payment out of the firm's assets prior to the customers and creditors of the firm.

The opinion of the Referee in the Finkelstein case follows:

"The Collector's claim * * * asserts a claim against Abraham Finkelstein for an unpaid balance of Income Tax for the year 1919, the balance being stated at $11,523.30. Priority in payment [fol. 108] before all claims, together with interest at 1% per month until paid beginning January 22, 1922, is also asserted.

The question of priority and of rate of interest will be reserved by the Referee for the present.

The entire Income Tax for the year 1919 asserted against Abraham Finkelstein is $15,364.40 of which he appears to have paid the instalment or one-fourth normally falling due in March, 1920, at $3,841.10. The remaining three instalments or three-fourth- aggregating $11,523.30 form the basis of the present claim.

On October 14, 1920, a petition in bankruptcy was filed against the partnership and the partners upon which petition the three partners individually and as a partnership was adjudicated on April 1, 1921.

It does not appear that the Collector prior to the filing of the petition in bankruptcy in October, 1920, ever took any steps against Abraham Finkelstein to collect the unpaid instalments of June 15, 1920, and September 15, 1920, either against the individual property of Abraham Finkelstein, including his interest in the partnership at that time.

At the hearing it appeared that all the assets in the hands of the Trustee in Bankruptcy are partnership assets and that the Trustee has no assets otherwise the property of Abraham Finkelstein. It was conceded Abraham Finkelstein had a substantial interest in any surplus of partnership assets remaining after paying partnership debts. It is however conceded that in this there is no surplus.

At the hearing the government contended that the Collector's claim was payable out of the partnership assets prior to the payment of the general copartnership creditors.

At the hearing the Trustee contended that the government's claim was only payable out of any individual assets (of which in this case [fol. 109] there were none) belonging to the individual estate of Abraham Finkelstein within subdiv. f of Section 5 of the Bankruptcy Act.

In other words, the Government's contention is that the tax assessed against Abraham Finkelstein should be paid out of the partnership assets prior to partnership creditors the same as if the Income Tax had been assessed upon the partnership as an entity as was the case under the Revenue Act of 1917; see Title II, Section 201 of that statute which reads as follows:

'That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereafter in this title referred to as the tax) equal to the following percentages of the net income. * * *'

It is to be noted that Title I of the Act of 1917 imposes an Income Tax upon the income of every individual and that Title II of the

Act imposes a graduated excess profits tax on a partnership as an entity.

The Revenue Act of 1918 under which the present tax was imposed upon Abraham Finkelstein was a departure from the plan of the Revenue Act of 1917 in not imposing a tax upon a partnership as an entity but declaredly imposed the tax upon the partner in his individual capacity and in respect to the income, whether distributed or not, which he was entitled to receive from the partnership.

The language of the statute is as follows:

'Sec. 218 (a). That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner [fol. 110] his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed.'

'Sec. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.'

It is also to be noted that these sections are found in Part II of the Revenue Act of 1918 entitled 'Part II—individuals.'

In my opinion the sovereign in the Act quoted has publicly declared its claim against the taxpayer and that the language of the statute, viz.; Section 218 (a) impliedly, if not expressly, follows or adopts the rule of marshalling laid down in subdiv. f of Section 5 of the Bankruptcy Act.

Had the partnership remained solvent and had the Collector pursued Abraham Finkelstein for the unpaid Income Tax the maximum right of the Government, in my opinion, under the statute would have been to pursue the individual assets of Abraham Finkelstein and to have pursued the latter's interest in the partnership after its affairs were marshalled under the familiar rule.

[fol. 111] I find nothing in Sections 3186 and 3466 or 3467 of the revised statutes of the United States which increases the res which the Collector may seize. Those three sections read as follows:

'If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment list was received by the collector, except when otherwise provided, until paid, with the in-

terest, penalties, and costs that may accrue in addition thereto, upon all property and rights to property belonging to such person; * * *.'

'Sec. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied, and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.'

'Sec. 3467. Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts so due to the United States, or for so much thereof as may remain due and unpaid.'

[fol. 112] Neither of these three sections attempts to define the assets of the taxpayer which are subject to seizure.

In my opinion the insolvency of the partnership or the partner who is the taxpayer does not increase the rights of the Government.

In other words I do not believe, because the partnership and the individual partners have become insolvent, that for that reason the Government to satisfy an unpaid tax imposed upon one partner as an individual can seize all the assets of the partnership in advance of the creditors of the partnership.

Non constat but that had the Government acted promptly in 1920 it might have secured from Abraham Finkelstein payment of at least two of the instalments of the tax out of his individual assets including his equity in the partnership.

The fact that the Government delayed collection until after such equity had disappeared and any other assets of Abraham Finkelstein had also disappeared affords no reason why the partnership assets, which otherwise would have belonged to the partnership creditors, should be now seized by the Government to pay its claim against Abraham Finkelstein as an individual under Section 218 (a) of the Revenue Act of 1918.

I repeat that the present controversy cannot be decided correctly without constantly keeping in mind the text of Sections 218 and 224 of the Revenue Act of 1918 quoted above.

Congress having deliberately chosen the plan of taxation indicated in those sections, instead of assessing the income of the partnership as an entity and making the tax thereby payable out of partnership assets in the first instance in case of a failure, the Col-[fol. 113] lector is precluded from asserting the different rule here contended for by him, even if (as he points out) the statutory plan

works (as here) to leave the partnership assets to the partnership creditors free from seizure to satisfy a tax imposed on one partner 'in his individual capacity.'

I read the following cases as supporting the views expressed in this memorandum:

U. S. v. Hack, 8 Peters, 271;
U. S. v. Evans, Crabbe, 60; 2 Fed. Cases, #15062.

The Collector relies on the following cases:

In re Straussberger, 4 Wood, 557, 23 Fed. Cases, #13526;
Lewis v. U. S., 92 U. S., 618.

In the Straussberger cases the United States had recovered a judgment on a whiskey bond against both of the Straussbergers who were partners in a whiskey business but who had each executed the bond in connection with that business in their individual capacities. It is evident to me that this feature was decisive of the case. The language at page 559, postponing the claims of partnership creditors as well as of separate creditors to the claims of the United States, must be read in connection with the limitation in the language of the opinion on page 558, beginning 'When the United States have a claim against one member of a firm and not against the other its priority extends only to the interest of that member, etc., etc.'

I cannot read the Lewis case as impairing the prior decision of the U. Supreme Court in U. S. v. Hack. The facts were as follows:

The United States had a claim against the partnership of Jay [fol. 114] Cook McCulloch & Co. of London, hereafter called the English firm.

On November 26, 1873, the American firm became bankrupt and Lewis was the Trustee in Bankruptcy.

The United States asserted against the Trustee in bankruptcy a claim against separate estates of the seven American partners in the American firm, they being partners in the English firm which was primarily the debtor to the United States.

The Supreme Court merely decided that the United States holding a claim primarily against the English partnership was not bound to go into a foreign jurisdiction to assert that claim against that partnership before proceeding against the separate estates of the partners in this country but could assert a claim against the separate estates of the partners so far as found in this country in the possession of Lewis, the Trustee in bankruptcy of the American firm. The decision cannot in my opinion be read as authority for the converse proposition contended for by the Collector, that the United States in holding a claim against a partner as an individual may assert that claim against the partnership assets ahead of the claims of partnership creditors, which is the proposition condemned in U. S. v. Hack, supra.

I report that the Trustee in bankruptcy in this proceeding is entitled to a decree barring the claim of the Collector of Internal Revenue against the partnership assets of Finkelstein Brothers in priority against the claims of the creditors of Finkelstein Brothers.

Such order should contain a provision expressly reserving the rights of the Collector of Internal Revenue against the individual estate of Abraham Finkelstein until it is made to appear that such an estate exists in the hands of the Trustee in Bankruptcy."

[fol. 115] Robert P. Lewis (Max E. Sanders, of Counsel), for Appellee, Henry H. Kaufman, Trustee.

White & Case (Lyle T. Alverson, Alfred C. Coxe, J. M. Hartfield, Henry H. Kaufman, Wm. St. John Tozer and Ralph Wolf, of Counsel), for Receiver Coxe.

William Hayward, U. S. Attorney; Nelson T. Hartson, Solicitor of Internal Revenue, Russell N. Shaw, Special Attorney, Bureau of Internal Revenue, and Victor House, Special Asst. U. S. Attorney, for Appellants.

MAYER, Circuit Judge:

The fundamental fallacy of the contention on behalf of the Government is that it confuses priority with the existence of a fund out of which taxes are payable or collectible.

The authority to tax must be found somewhere. The Revenue Act of 1918, in Section 1400 thereof, specifically repealed, inter alia, Title I including Section 8 (c) of the Revenue Act of 1916 and Title II, including Section 201 of the Revenue Act of 1917.

The provisions of the tax statute here concerned are thus Section 218 (a) and Section 224 of Title II of the Revenue Act of 1918. As pointed out in the opinion of the Referee, supra, there is not the slightest warrant for concluding that the tax was against partnerships and not solely against the "individuals carrying on business in partnerships." The language of Section 218 (a) is too plain for extended discussion and its meaning could be fortified, if necessary, by the contrast between the Revenue Act of 1917 and the Revenue Act of 1918 in this regard.

As, therefore, there was no income tax against the partnership in either of the cases at bar, we must look to the bankruptcy statute to [fol. 116] ascertain whether it affirmatively provided that the tax assessed against the individuals could be proved against the partnership estate. We need not pause to consider what distinction, if any, there is between "debts" and "taxes" in various parts of the Bankruptcy Act. We may also assume for the purpose of the argument that, if the Revenue Act of 1918 authorized assessment of the tax against the partnership instead of against the individuals, it might not have been necessary to name the United States in any provision as to marshalling.

The point, however, is that, as there is no tax against the partnership, the only remaining theory upon which the tax against the individuals can be proved against and recovered out of the partnership estate is that the Bankruptcy Act of 1898 so provided.

Section 5, subdivision (f) of that Act did not so provide. This provision reads:

"The net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnerships."

There can be no longer any doubt that the distinction between individual and firm debts is a matter of substance which cannot be disregarded.

[fol. 117] In re Wilcox, 94 F. R., 84;
In re Janes, 133 F. R., 912;
In re Schall v. Camora, 251 U. S., 239;
In re Jarmulowsky, 287 F. R., 703.

There is, of course, no doubt that the right of priority of the United States in the collection of taxes is an attribute of sovereignty.
Marshall v. New York, 254 U. S., 380.

Under Section 64 (a) of the Bankruptcy Act of 1898, it is the duty of the court to order the trustee to pay all taxes, legally due and owing by the bankrupt to the United States, in advance of the payment of dividends to creditors; but, of course, the tax must be "legally due and owing by the bankrupt to the United States."

U. S. R. S., Sections 3186, 3466 and 3467 deal with tax priority, but there is nothing in the provisions of these sections which changes the tax against an individual into a tax against the partnership. Numerous instances will be found in the case of In re Wilson, 252 F. R., 631, which illustrate the difference between the identity of the fund or person against whom a claim can be made and respective priorities once the fund or person is found or determined. If, therefore, the Congress had intended that the tax against the individuals should be paid out of the partnership estate prior to the payment of the partnership debts it would have so declared by some affirmative language to that effect either in section 5 (f) of the statute or in some other provision.

It must be remembered that the Bankruptcy Act of 1898 has now been in operation for a little over a quarter of a century and that business has been done on the faith and basis of the statute. It can [fol. 118] readily be seen that a partnership might not be able to obtain the same amount of credit from banks and other lending sources if in marshalling the assets of a partnership, such assets become a fund out of which the debts or taxes due and owing from the individual members are payable prior to or pari passu with the partnership debts.

As pointed out by Judge Rogers in United States v. Wood, 290 F. R., 109, there is a marked difference between the Act of 1898

and previous acts in respect of the relation of the United States to the present bankruptcy act. In the case just cited, there is a review of many cases illustrative of this proposition. It is hard to believe, in view of the definite language of Section 5 (f) that the legislature intended to create a situation where the debts or taxes due from the individuals might either wipe out or share with the debts due from the partnership; for any such provision might well have been most detrimental to business and commerce. Of course, it is always within the power of the Congress to tax the partnership as distinguished from the individuals, but where, as here, no such tax exists, we confess that we are unable to find anywhere in the Bankruptcy Act of 1898 any provision which authorizes the collection of the tax from property which was never taxed.

United States v. Hack, 8 Peters, 271;
United States v. Evans, 25 Fed. Cases, 1023.

The cases of Lewis v. United States, 92 U. S., 618, and In re Strassburger, 23 Fed. Case, 224, have been analyzed in the opinion of the Referee and the Lewis case has been further commented upon in the Wood case, supra, at pages 111 et seq.

Our attention has been called to a decision of the District Court of New Jersey in the Matter of Brezin & Schaefer, not reported. We are unable to agree with this decision. (Note.) There is nothing [fol. 119] in the record of either of the cases at bar upon which an equitable lien against the partnership assets may be asserted in favor of the United States. "Equitable lien" is often used synonymously with "equitable assignment" and "impressing a trust." An excellent definition is found in Lighthouse v. Third National Bank, 162 N. Y., at page 344:

"One of the first essentials to the creation of an equitable lien is the specific thing or property to which it is to attach.

Though possession is not necessary to the existence of an equitable lien, it is necessary that the property or funds upon which the lien is claimed should be distinctly traced, so that the very thing which is subject to the special charge may be proceeded against in an equitable action and sold under decree to satisfy the charge."

See also,

Pomeroy on Equity, Fourth Edition, Vol. 3, Section 1233;
Bispham on Equity, 4th Edition, Sec. 351;
Ketchum v. St. Louis, 101 U. S., 306;
Walker v. Brown, 165 U. S., 654;
National City Bank v. Hotchkiss, 231 U. S., 50, 57;
In re National Cash Register Co., 174 F. R., 579;
In re See, 209 F. R., 172.

(NOTE.)—See interesting article in Columbia Law Review, April, 1924, entitled "The Priority of the United States in the Payment of its Claims against a Bankrupt" by Ralph F. Colin, at pages 360, 371 and 372.

Every element of an equitable lien is absent in each of the cases here under consideration.

Finally, there is no merit in the suggestion that the marshalling provisions are not applicable in the Jones & Baker case because there the composition in that case was had before adjudication. The composition was only with the partnership creditors and there was no [fol. 120] composition with the creditors of the individual partners. This was warranted by Section 12 of the Bankruptcy Act, as amended June 25, 1910. In re Breitbart, 291 F. R., 693.

A composition whether before or after adjudication, so far as affects the questions here presented, stands in the same position as a liquidation through a trusteeship in bankruptcy. (See opinion of Referee Remington, Matter of Simon Fox, 6 A. B. R., 525, 530.)

It is plain that under the Bankruptcy Act, it is intended that its administrative sections shall apply whichever method of administion may be chosen.

We think it unnecessary to comment in detail upon many cases cited in the briefs. It is sufficient to observe that three cases upon which some emphasis is laid by appellant, i. e., Matter of Menist, 294 F. R., 532. U. S. v. McHatton, et al., 266 F. R., 602 and Titus v. Maxwell, 281 F. R., 433, either are not relevant to the question here under consideration or contain nothing to disturb the conclusion that the decrees below were correct.

Decrees affirmed.

[fol. 121] In United States Circuit Court of Appeals

[Title omitted]

Judgment—Filed April 14, 1924

Appeal from the District Court of the United States for the Southern District of New York

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Southern District of New York and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed.

H. W. R.
J. M. M.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

[fol. 122] In United States Circuit Court of Appeals

Clerk's Certificate

I, William Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby Certify that the foregoing pages, numbered from 1 to 49 inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of In the Matter of Jones & Baker, Alleged Bankrupts; United States, Appellant, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this 23rd day of June in the year of our Lord One Thousand Nine Hundred and twenty-four and of the Independence of the said United States the One Hundred and forty-eighth.

Wm. Parkin, Clerk. (Seal of United States Circuit Court of Appeals, Second Circuit.)

[fol. 123] In Supreme Court of the United States

On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

Order Granting Petition for Certiorari—Filed Oct. 13, 1924

On consideration of the petition for a writ of certiorari herein to the United States Circuit Court of Appeals for the Second Circuit, and of the argument of counsel thereupon had, as well in support of as against the same, it is now here ordered by this Court that the said petition be, and the same is hereby, granted, the record already on file as an exhibit to the petition to stand as a return to the writ.